PRIVATE CORPORATIONS AND THEIR CONTROL

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To the Memory of
My Friend
KARL MANNHEIM

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INTRODUCTION

This book is concerned with the problems of private corporations and their control. By private corporations are meant associations formed to carry on some business undertaking, and possessing the attributes of a legal entity. This terminology is almost identical with that used in the legal and economic literature of the U.S.A. It is the company limited by shares, the *Société Anonyme*, the *Aktiengesellschaft*, with which we are concerned. The word "control" will cover both the distribution of power within such corporations and the supervision of their management both by their own members and by the public authorities.

It has seemed best to begin by reviewing the evolution of corporate enterprise both in its economic and legal aspects from the time when business corporations were exceptional creations of the sovereign power until they became an important and indeed a paramount factor in economic life, and next to ascertain what part they play in our own day. The legal framework within which they operate is then examined from the point of view of the more important legislative systems, as set forth in statutes and illustrated by judicial decisions. By considering what has been done in former times and what is being done to-day, and particularly by examining the attitude of public opinion and of the law towards corporations, we shall be able to find the right approach to the problems of our own "age of transition".

In the second half of last century public opinion tended to favour corporate enterprise, being deeply impressed by its achievements in railway and canal construction, in industry and finance; and the law freed corporations from the administrative fetters which rendered their formation difficult, giving them full power to settle their constitutions as they thought fit. In consequence corporate enterprise invaded every field of economic activity, and big concerns were built up through amalgamations and holding companies. With the formation of such giant corporations and through the struggle against monopolies and trustification, the public became conscious of the dangers of *laisser-faire*, and at present the trend of opinion is to some extent against corporate enterprise.

It is our aim to show, by an unprejudiced investigation, that whereas corporations are indispensable if economic progress is to be maintained, a number of legislative reforms are required in order to reinforce public control and to give better protection for shareholders' rights. These suggestions will be connected with an analysis of the British Companies Act of 1948 and of the recent creation of publicly owned corporations to carry on nationalised industries in Britain.

PART I

Historical and Economic Background

CHAPTER I

THE EVOLUTION OF CORPORATE ENTERPRISE

1. Business Associations in the Ancient World

There is a strong tendency to seek in antiquity for the roots of modern institutions, and many writers have claimed to find precursors of the joint-stock company in ancient days. Though the facts show that such a belief is erroneous, it is worth while to summarise what we know of business associations in the ancient world.

As early as the Code of Hammurabi (2075–2025 B.C.) we find rules governing the making of contracts by an entrepreneur who receives money or goods from a financier to be used as capital for foreign trade. After his return he must account for stock received and profits earned. The risk of loss by enemy action was to be borne by the capitalist; the commercial risk by the trader, who must repay double the amount received if his venture failed. Curiously, no provision was made for distributing the profits between the parties in case of success. This, obviously, was always done by agreement.

The tile-documents relating to such contracts which have been laid bare by excavations extend over a long period. In some cases one party was capitalist, one trader; in others two or more contributed both money and labour. Evidently even at this early stage two types of association had been evolved: one resembling the *societas*, in which all the parties share the risks both as capitalists and as traders; the other similar to the medieval *commenda*, in which one party alone undertakes the management and bears the commercial risk.

For trading associations in ancient Egypt and Phoenicia there are unfortunately no materials available (1). We know, however, that in Greece partnerships were common, even for enterprises of colonisation, though there is no evidence that such undertakings had a corporate character and even less reason to suppose that they could be compared to joint-stock companies. But Greek commerce is known to have made use of partnerships in which one partner furnished the whole capital while the other

acted as entrepreneur, profits being distributed by agreement between them.

The Greek city states contracted out the collection of taxes and excise duties to private persons, generally by the year. Usually only one person made the contract with the city, his partners merely contributing a portion of the necessary capital. Such "sleeping" participants were under no liability to the State. We do not know whether their rights and shares were transferable, nor whether their liability as against the contractor was limited to the amount of their shares, although limited liability is asserted by some authors. But the death of a participant did not dissolve the contract (2).

At Rome partnership was used widely for various purposes. In applying the rules developed for the contract of *societas* it did not matter whether the *societas* was for profit or for some idealistic purpose. It therefore resembled the European partnership of private law as contrasted with commercial partnership, or the partnership proper of Anglo-American law.

Roman law gave the partners a wide choice in regulating their relationship. Unless otherwise stipulated the *socii* had to contribute in equal shares both capital and labour, and to share equally both profits and losses. Some authors have asserted that *societates* resembling the *commenda* were formed, e.g. by bankers. But since our texts do not deal with such contracts we may assume that they cannot have been frequent.

The *socii* were not regarded as agents of each other unless there was authorisation for the contract. Consequently a *socius* was liable as against third parties only if he made the contract himself, authorised it in advance or subsequently ratified it. Each *socius* was co-owner of the property. The *socii* were not jointly and severally liable for the obligations and debts of the *societas*, except in some special cases, such as a banking business. But such liability might arise from express agreement with a creditor, or by law in cases of tort committed by several *socii*. The death of any one of the *socii* dissolved the *societas*, and any of them could dissolve it at any time by renunciation. The only remedy of the remaining *socii* was a claim for damages in case of fraud or when the renunciation was made at a time disadvantageous for the *societas*. The right of renunciation was not affected by agreement to the contrary, and could be exercised even if the *societas* was formed for a fixed term (3).

Our texts contain several rules relating to partnerships formed for tax farming or for exploiting State properties, such as mines and quarries: the *societates publicanorum* or *societates vectigales* (4). The contracts, alternatively called leases or purchases, were usually made for a five-year term on the basis of public auction. We hear of contracts made by all or several of the partners, and of others made by one person, the *manceps* or *auctor*, with whom one or more other persons participated. Not much is known of the position of such participants, except that they did not assume any liability towards the State. In substantial contracts there were probably many participants; one fragment speaks of a *societas* in which a thousand persons may have taken part. The death of one of the *socii* did not dissolve the *societas*, unless it were that of the *manceps* or the *socius* who managed the contract. It might be stipulated that in case of death the *heres* should become a *socius*; otherwise he would become a participant without a share in the management. Whether renunciation was possible in the case of a *societas vectigalis* is not clear. The share of a *socius* was not transferable *inter vivos*; whether that of a *particeps* was assignable we do not know, though Rostovtzeff asserts that shares and bonds in *societates publicanorum* were purchased and sold at Rome (5). Since we know of no special rule about resolutions, it is to be assumed that unanimity was necessary.

It has been often asserted, especially in earlier times, that the *societates publicanorum* had corporate capacity. Actually the texts say only that the *socii* of such partnerships might be authorised to form corporations, to have a *corpus*. Some Romanists consequently maintain that the *societas publicanorum* might be either a *societas* proper or a corporation, at the choice of the *socii* (6). But it is hardly probable, in view of the short terms for which the contracts were made, that corporations would have been formed in such cases. It is more likely that these texts relate to trade associations, resembling guilds, of persons occupied in tax farming, or to permanent associations formed by financial groups to find the capital for such enterprises (7).

Under the Empire the collection of taxes gradually became the duty of the bureaucracy, and only minor and generally local taxes were leased to *societates*. Consequently these lost their importance; but it is probable that tax farming on a small scale survived, for Byzantine Imperial texts contain references to it (8).

Although Roman law seems not to have known of business

associations on corporate lines, its attitude to corporations was not without importance for the evolution of corporation law. It is recorded that under the Republic associations could be freely formed without need for the assent of the State authorities. We find traces of many religious, burial and convivial associations, and of associations of craftsmen and traders. But we have little information about them, especially on the question whether or not they had legal personality. Under the old civil procedure there is no doubt that associations could not sue, since representation in legal actions was not admitted.

A Lex Julia, probably of 7 B.C., whose text is lost, required the assent of the Senate, or in the provinces that of the Governor, for the lawful formation of associations. Only small associations of a religious, funerary or convivial character, the so-called *collegia tenuiorum*, might be freely formed. An association which did not secure the necessary assent was illegal. But whether the approval of itself gave an association corporate status is disputed. Some authors believe that to acquire legal personality, an association had to receive a special concession of corporate status (9). Mitteis asserts that it was only after the time of Marcus Aurelius (A.D. 161–177) that the authorisation conferred juristic personality as a consequence without a special grant (10). If this is correct, such special concession would have been necessary for some two centuries after the Lex Julia.

It was long before Roman law accepted the idea that a corporation as distinct from its members might acquire and own property. In the case of public corporations there are *dicta* in the texts to the effect that things which belong to the State or to a municipality are nobody's property, *res nullius*, since they belong to the people as a whole or to all the burgesses, and consequently there is no private property in them (11). In classical Roman law, however, it is quite clear that a thing owned by a corporate body is the property of the association as such, quite distinct from the property of the members. It is likewise recognised that a debt due to or by a corporation is that of the corporation and not of its members (12).

Liability on the part of a corporation for torts committed by its officers or agents was not recognised. In the case of the *actio doli* this is expressly stated, on the ground that a corporation is incapable of committing a *dolus* (13). In such a case the officers or agents who had taken part in such acts were alone liable for

the tort. One text asserts the liability of a municipality for coercion, but distinguished Romanists hold that this text is to be understood as being based on the fact that in the case in question the burgesses took part in the coercion, and the *actio quod metus causa* was given for this. In late Roman law a corporate association could probably sue and be sued through its officers.

Nothing more definite can be said; and it is specially to be noted that Roman law had no theory of corporate personality. Some of the texts are in consequence not quite explicit. There is, for example, one in which the possibility of a common volition on the part of the burgesses of a municipality is denied: *universi consentire non possunt* (14). The texts do not furnish a firm basis for the doctrine that under Roman law associations had only a fictitious existence, though it is maintained that the doctrine of the *ficta persona* was already accepted in pure Roman law (15).

We may conclude, then, that the ancient world did not recognise business associations with corporate personality, and that business life remained individualistic, in so far as private enterprise was not prevented by the encroachments of *étatisme*. "To pass from individualism to compulsion was the normal way for a Græco-Roman community" (Rostovtzeff).

SOURCES

1. Goldschmidt, *Universalgeschichte des Handelsrechts* (1891), pp. 50–51; Rehme: Ehrenburg, *Handelsrecht*, vol. I, *Geschichte des Handelsrechts*, § 7, pp. 52–67.

2. Rehme, *op. cit.*, § 8, pp. 67–73.

3. Windscheid-Kipp, *Pandekten* (1906), II, §§ 405–408; Dernburg-Sokolovsky, *System des Römischen Rechts* (1910), 77, 381–385; Buckland, *Textbook* (2nd ed., 1932), 177–178; Buckland and McNair, *Roman Law and Common Law* (1936), 227–234.

4. Cohn, *Romisches Vereinsrecht* (1873); Kniep, *Societas Publicanorum* (1896); Mitteis, *Römisches Privatrecht*, I, pp. 408–414; Buckland, *op. cit.*, p. 513.

5. M. Rostovtzeff, *Economic History of the Roman Empire* (1926).

6. E.g. Jörs: Kunkel-Wagner, *Römisches Recht* (2nd ed.), p. 75.

7. Buckland, *loc. cit.*

8. Rostovtzeff, *op. cit.*, *passim.*

9. From the literature, cf. *for* the doctrine of special grant Savigny, *System*, II, § 89, p. 275; Gierke, *Deutsches Genossenschaftsrecht* (1881), III, § 6, p. 97; *against:* Windscheid-Kipp, I, § 60, p. 2; Dernburg-Sokolovsky, § 51, p. 219; Siber, *Römisches Recht* (1926), p. 52.

10. Mitteis, *Römisches Privatrecht*, pp. 400–401.

11. Gaius, D.1.8.1.

12. "*nec enim plurium servus videtur sed corporis*", Ulpian, 48.18.1.7. "*Siquid*

universitati debetur, singulis non debetur, nec quod debet universitas, singuli debet", Ulpian, D.3.4.7.1.

13. Ulpian, D.4.3.15.1.

14. Ulpian, D.4.2.9.3.

15. Cf. generally Buckland and McNair, *op. cit.*, pp. 50–55, and for the fiction theory Windscheid-Kipp, I, § 57.

2. Medieval Business Associations on the Continent of Europe

Until the time of the Crusades there was little scope for business associations in medieval Europe. Handicraft and commerce were insignificant in comparison with agriculture. For the industrial products they needed, princes and feudal lords made use of what could be provided by such of their own bondsmen and serfs as were skilled in some craft. The small craftsmen in the towns were mainly engaged in satisfying local needs. They were organised in guilds which gave their members protection and secured their existence by the monopolies and privileges granted to them at the expense of outsiders, while restricting their activities by rigid rules as to admission to the guild, the number of journeymen and apprentices permissible, and so on. Inter-state commerce was scanty, being mostly restricted to luxuries such as spices, silk and jewellery. It took place chiefly through fairs.

The backbone of trade and industry was the individual. Partnerships no doubt existed, especially between near relatives, but probably played no important part before the close of the 11th century, for the system did not favour associations between guild members.

With the Crusades trade with the Near East revived and sea traffic from Italian ports sprang up. Capital began to accumulate in Italian cities. Manufacturing enterprises of relatively large size were established, working partly for foreign markets. These, like the sea trade itself, demanded larger capital resources; and from about the beginning of the 12th century we hear of partnerships. Many of these were of a new type, generally called *commenda*. In these one partner, the *tractator* (*commendatarius*), undertook the management of the venture, and the purchase, transport and sale of the goods, and was responsible to creditors. The other partner, the *commendator*, provided the capital, but undertook no further obligations or liability. The simplest and

perhaps the original form of *commenda* was that with one *tractator* and one *commendator*. Some *commendas*, however, had more than one *tractator* and *commendator*, and sometimes the *tractator* or *tractatores* furnished a part of the capital, in which case the partnership was called *collegantia*.

Whether *commendas* were adopted originally for land or for sea trade is disputed. Many, established for a single venture, were dissolved after the goods were sold. But some were made for fixed periods, several ventures being concluded within the stated time.

The partnership proper also remained in being. The medieval partnership or *compagnia*, however, differed from the Roman *societas* in important respects. It gradually became accepted that any partner might act as against third parties on behalf of all the others, and could dispose of the common assets. Furthermore the partners became jointly and severally liable for the partnership's debts. The origin of this fundamental difference is attributed to the German idea of the *Gesammt-Hand*. It is not known just how early these principles were adopted; they certainly existed in the 13th century.

In seaport towns partnerships for the acquisition and joint ownership of single vessels also became common, by reason of the heavy cost of a ship suitable for the Mediterranean trade. The capital necessary was provided, generally in equal shares, by several capitalists, often as many as 24. The master of the vessel, a skilled seaman entrusted with the direction of the voyage, might or might not have contributed a part of it. Even more complicated arrangements are on record. In some cases the vessel was owned by a partnership, the goods provided by a *commenda* and capitalists helped to finance the expedition with loans, either at interest or against a share in the profits (1).

Associations were also formed to procure the necessary capital for expeditions by the armed forces of Italian cities. The sums required were relatively substantial, and large partnerships became necessary. These associations, or *maone*, were granted a share in the profits of the expedition. The most famous was the Maona Giustiniani, formed for the Genoese expedition to the island of Chios and its subsequent occupation.

The needs of the city-states for loans became so considerable that the organisation of associations with a numerous membership was necessary to procure them. These associations obtained

special privileges in the form of the pledging of taxes and other public revenues for the service of the capital and interest. The principle was the same as in the case of the *maone*, but these associations were often called *compere* because they were considered as buying the payments due to the city with the money they lent.

Both *maone* and *compere* showed some features of corporate organisation, and many medievalists assert that they were in fact corporations; some even consider them as joint-stock companies in the proper sense. While this is uncertain, we know that one such organisation, the Casa di San Giorgio at Genoa, created in 1408, became a corporation in the course of time. This was originally an association of all the creditors of Genoa, and had a substantial capital divided into equal shares of 100 lire each. One or more of these shares (*loca*) might be held. Originally the association was entitled to interest. Later, however, the city could not meet the interest charges due to the creditors, for the net income from the taxes pledged was not sufficient to cover them fully. An arrangement was therefore made by which the association renounced its right to anything more than the income from the pledged revenue, and in consequence the participants were entitled only to dividends from profits. Beside managing the taxes the Casa engaged to a certain extent in banking. The management was entrusted to eight "protectors", originally appointed and subsequently elected by the chief shareholders. Although the number of shares amounted to several hundred thousand, only 480 participants, i.e. those who owned at least ten shares, were entitled to be present at the meetings. The qualification of the "protectors" was ownership of 100 shares; the members of a larger board (*procuratori*), eventually numbering 20, had each to own at least 40 shares. The shares were registered and transferable. Shareholders could demand share certificates, and from 1456 onwards dividend certificates also, which could be transferred separately.

The Casa had a long life, being dissolved only after the occupation of Genoa by France; its winding-up was completed as late as 1817. It had very few imitators in Italy: the most noted was the Casa di Sant' Ambrosio at Milan, formed in 1598. This institution, however, was organised on different lines, and the real owner was the City of Milan. The City was liable for the debts of the Casa, and had the right to redeem the shares.

Central Europe took no great part in Mediterranean trade; its goods were transported overland or through northern ports. Economic activity evolved much more slowly than in the south, but from the 14th century onwards there was distinct progress. For Germany especially detailed information is available. The guild organisation shows the features already mentioned. The evolution both of *commendas* and of partnerships proper is noteworthy.

Whether the evolution of *commendas* was or was not due to Italian influence, whether they originated in seaports, and whether the *commenda* or the partnership was the original form of joint enterprise, are all matters of dispute. The fact is that all the famous commercial, manufacturing and banking houses were partnerships, most often family partnerships. Sons were taken as partners by their fathers, and remained partners after the father's death. The contracts were mostly for short periods, say five or six years; they could be, and usually were, repeatedly renewed. The houses of Fugger, Welser, Imhof and others were such partnerships based on short-term agreements renewed over long periods. The Ravensburg company, a partnership formed in 1380, survived until 1530 on the basis of constantly renewed six-year contracts.

In seaport towns common ownership of vessels for trade or transport was well known. Associations of creditors of public bodies are said to have existed in Germany also, but about them nothing definite is known.

Organisations of special types arose in the mining industry and metal trade. Records and by-laws of German mining companies exist from the end of the 15th century onwards; these show a gradual evolution from the common ownership of mines operated by the owners independently in separate seams to the exploitation of the whole mine as a single unit on the common account for common profit or loss. This evolution was probably promoted by tax legislation. A fixed portion of the product had to be paid as taxes, and work must go on without interruption. Failure to work the seams or to pay the tax involved forfeiture, and the organisation of the mining company (*Gewerkschaft*) had to provide accordingly. The membership share (*Kuxe*) entitled to a part in the profits, but imposed the obligation of contributing to recoup losses. The exploitation was directed by the officers. The corporate status of these mining associations was a result of later

developments, but for a long time the members (*Gewerke*) were not only under the obligation to make payments (*Zubusse*) when called upon, and exposed to forfeiture if they failed to do so, but were also liable to creditors. On the other hand they could avoid further contributions by abandoning their share to the company. The shares also became transferable. Thus the mining associations, originally groups of miners working mines in common, turned into capitalistic enterprises with corporate capacity.

In the metal and especially the tin and copper industry, joint enterprises came into being. Working with relatively large capitals, they made loans to miners and mining companies, at the same time contracting to purchase their products. Loans to public bodies in order to secure trade monopolies for the company are also recorded. The company traded through its officers. The members, or participators, could admit sub-participators who were not in direct relationship with the company and had rights only as against their principal. The best known of these companies was the Iron Trading Company of Steyr, incorporated as late as 1581. Only inhabitants of the town of Steyr could become members, and the governor was appointed by the Town Council. The capital, called *Hauptkapital* (*Leggeld*), was divided into shares. The assets of the company were distinguished from those of the shareholders; the distinction is not so clear with regard to debts. The officers were bound by the by-laws to keep proper books of account.

Non-business corporations, both ecclesiastical and secular, were numerous in medieval Europe. It is asserted, especially by Beseler, Gierke and others, that corporations, whether townships, other public bodies, guilds or voluntary social associations, could be formed freely, and by resolution of their members could obtain corporate status. The doctrine of the German "Fellowship" (*Genossenschaft*) is based on this assumption. The Church, however, opposed the free formation of corporations, maintaining that the creation of ecclesiastical corporations was the prerogative of the Pope, as earthly representative of Christ. The final acceptance of this doctrine is attributed to Pope Innocent IV (1243–1254). It was elaborated by the Canonists, and is based on the fictitious personality of corporations. Corporations are not real persons as human beings are; they are merely regarded as such by a rule of law, to which their existence is due. Rules

of law can be introduced only by the legislator, and therefore the sovereign power alone can create corporations. This doctrine was eagerly taken up by secular rulers, and it became an accepted principle that no corporation could be created except by charter from the sovereign. The acceptance of this thesis was obviously facilitated and promoted by the influence of Roman legal traditions as then understood.

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1. L. Goldschmidt, *Universalgeschichte des Handelsrechts* (1891), *passim*, esp. pp. 255–290; P. Rehme: Ehrenberg, *Handbuch des Handelsrechts* (1913), I, pp. 101–104; H. Sieveking *in* J. G. Dillen, *History of the Principal Public Banks* (1934), pp. 15–35.

2. Gierke, *Genossenschaftsrecht*, I, *passim*; Rehme, *op. cit.*, pp. 114–140, 162–169; J. Strieder, *Studien zur Geschichte Kapitalistischer Organisationen* (2nd ed., 1925); E. F. Heckscher, *Mercantilism* (English ed., 1935), I, c. vii; Gustav Schmoller, *Jahrbücher*, vol. XVII (1892), pp. 359–391.

3. Joint Enterprise in Medieval England

It is sometimes said that merchants and craftsmen were already organised in guilds in Anglo-Saxon times, and that guilds could be freely formed without the need of a charter. It is true that shortly after the Norman Conquest the "gild merchant", an organisation which included both merchants and craftsmen, appeared in a number of English towns. Later, special guilds for craftsmen and for wholesale and retail merchants replaced the gild merchant. Some towns, London probably among them, never had a special "gild merchant", but always possessed separate guilds for the various trades and handicrafts. After the Conquest we hear no more of the free creation of guilds: a royal charter was essential. Guilds, however, were undoubtedly legal entities.

The guild was an exclusive local organisation of the trade concerned. A trader had to be a member of the gild merchant, a craftsman of the guild of his craft. Membership carried with it an exclusive right to exercise the calling within the town limits; members of guilds of other towns were regarded as strangers. Guild membership was therefore a valuable asset, and admission became more and more difficult because of high fees and other burdensome conditions.

The activities of the members were extensively regulated; the

number of their employees and apprentices was strictly limited; conditions for their employment laid down, and the quality of goods controlled—the regulation extending in some cases even to certain aspects of the members' private lives. The craftsman carried on his craft with the aid of a few journeymen and apprentices, and his capital outlay was small; he worked mainly for the local market and for fairs.

The main activities of the guilds were the supervision and protection of their members. In some cases they also provided certain facilities, such as the use of trading establishments. Some guilds bought materials or goods for distribution among members, or even held pre-emptive rights on certain goods.

The guild system discouraged the evolution of large enterprises and tended strongly to preserve equality. In the gild merchant there was generally a rule giving any member the right to share in the purchases of any other: the right of the lot. This state of things did not favour the formation of business associations, whether partnerships or otherwise, while associations with non-members were in most cases expressly prohibited. Yet this form of organisation sufficed to meet all needs over a fairly long period.

A substantial part of manufacture and commerce, however, was carried on by foreigners. Many Italian goldsmiths and merchants, and Flemish and French craftsmen also, lived and worked in London. The Hansa of Cologne had a permanent establishment in London from 1157 onwards. Hansas of other German cities were admitted later, and in 1320 the "Hansards" occupied the "Steelyard", which in 1475 became their property.

Increased prosperity brought differences in wealth and position among the guild members. In London the more prosperous guildsmen formed the various Livery Companies, and in spite of the opposition to business associations, partnerships are recorded from the beginning of the 13th century, among them some of the *commenda* type, which later on lost its popularity in England. Possibly such partnerships were formed by, or under the influence of, Italian merchants. The normal form of joint enterprise was the partnership, similar to that of German law.

The strongest factor in the break-up of the guild system was the evolution of the English wool trade. English wool was in constant demand on the Continent by reason of its high quality. As a result sheep-breeding in England increased, and wool

exports grew. Originally the trade was dominated by German and Italian merchants, who came to England to purchase the wool and carried it home in their own ships. English merchants tried to procure the trade for themselves, but this could not be managed by the local guilds: a national organisation was necessary.

This was achieved by the Company of the Staple. Several towns were designated as "Staples", and wool could be exported only from them. Footholds were also established on the Continent, but their use was interrupted by the frequent wars. The Company's claim to have been founded in the 13th century is disputed, but its charter of 1391 is preserved.

The Staplers had not only foreign competitors to contend with; they were constantly attacked in England itself. These attacks were the consequence of endeavours to develop the cloth manufacture. Not only should the home market be reserved to English craftsmen and the import of foreign cloth prohibited; even the surplus wool should be exported in the form of finished cloth. These endeavours met with some success: from the 15th century the export of wool declined and that of cloth increased, in spite of the strong opposition of foreign governments. The weaving, dyeing and finishing of cloth could be carried on outside the towns, particularly in the neighbourhood of rivers. Clothiers preferred to establish workshops outside the town boundaries, so as to avoid the strict supervision of the guild and to employ cheaper labour. Larger and larger establishments grew up, and the beginnings of capitalistic production appeared as workshops employed more labourers and entrepreneurs gave out work to small craftsmen and their families in the villages. The export of cloth on the other hand demanded a national body similar to the Company of the Staple. This organisation was the Company of Merchant Adventurers. The exact date of its formation is not known; they themselves claimed that it existed as early as the 13th century. Its first known charter was granted in 1407.

This company, like that of the Staple, was a national organisation. Most of its members indeed were Londoners, and in its activities their influence prevailed. But there were branch organisations with some degree of independence in provincial towns, and their members secured part of the trade.

The Merchant Adventurers carried on a vigorous struggle both with foreign merchants and with the Staplers, and aimed

at acquiring the country's entire export trade. They sought the abolition of the privileges granted to the German Hansa, and tried to make the Government prohibit the export of raw wool. In both aims they were eventually successful. The Steelyard was seized by the Crown in 1550, and the export of wool constantly diminished. Consequently the Company of the Staple fell into decay.

But even with the clothiers there were differences. The Merchant Adventurers wanted to export white (unfinished) cloth, whereas the clothiers tried to reserve the whole finishing process for themselves within the country.

These companies, according to the famous definition of Sir Josiah Child, did not themselves trade, but regulated the trade with which they were concerned; hence their name of "regulated companies". The members traded under constant supervision and regulation by the Company. The doors of both companies were open: any merchant could join them on payment of a fee. Both were national organisations, and members could enter them without being members of a guild. Their monopoly gave their members a privileged position and protection against interlopers. One advantage was freedom to use the posts on the Continent and the Company's warehouses. Lastly, both companies had a corporate status, based upon the royal charter. There was a common name, a common seal, perpetual succession and a body of management consisting of one or two governors and a certain number of assistants.

Both companies owned important assets, including establishments for their members' use. Each had a substantial income from entrance and other fees and certain other imposts.

The trading activities of the members were strictly regulated and supervised, the control extending to the quality of the goods and the maintenance of trade rules and customs. The companies also tried to ensure equal distribution of trade, and rules were drawn up to regulate the quantity of the turnover, the so-called "stint". In consequence, partnerships between members were not favoured; but they could not be prevented, and the establishment of groups, mainly for definite occasional ventures, is on record.

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E. Lipson, *The Economic History of England*, I (8th ed., 1937), c. ii–iii; II (3rd ed., 1943), c. ii.

4. Early Trading Companies

The discovery of the sea routes to India and America brought about fundamental changes in long-distance trade. Voyages became longer and more dangerous. There was the risk of ships and crews being seized in the frequent wars for maritime domination. Piracy was rampant. The adventurers had to protect themselves and their goods against the attacks of native princes and the violence of their subjects. The ships had to be armed, and fortified trading posts built and maintained.

Clearly, neither individual merchants nor even partnerships could meet these contingencies. Stronger concentrations of material power were necessary, if only because the capital invested in an expedition was locked up for a much longer time before goods obtained in the East or in America could reach the home ports and be sold or distributed. But the ways and means adopted to this end differed widely.

The two powers which originally dominated the African, Indian and American trade—Portugal and Spain—produced no new forms of capital association, but tried to solve the problem by engaging the aid of the State. Portugal's trade with Africa and India was until 1577 a State monopoly. The State provided not only for the protection of convoys by armed vessels, and the erection and manning of fortified posts, but also for the purchase of goods, their sale or barter for colonial products, and the sale of those products on arrival. From the beginning the productivity of this State monopoly was hampered by the peculation of officials and of the captains and crews of the vessels, and the expeditions incurred large losses.

Private commerce, which had always been free to Brazil, was generally allowed in 1577. But the improvement expected did not come about. Numerous associations for this trade came into being after 1577, none of them on a large scale; their legal structure was similar to that of the Italian *maone*.

In Spain trade had always been left to private enterprise, though subject to State control; private ships were not allowed to sail unaccompanied. They had to call at designated ports, where convoys consisting of both State-owned and private ships were formed, and escorted by armed naval vessels. Commerce with the Spanish colonies was mainly carried on by partnerships on the old and familiar lines. There was a strong infiltration of

foreign capital not only into overseas trade but also into the Spanish mining industry. The part played by German firms such as the Fuggers and Welsers was prominent, especially in mining.

In the United Provinces quite another line was taken. Here, until the end of the 16th century, trade and shipping, including long-distance sea trade, were in the hands of individuals and partnerships. The strong individualism of Dutch merchants and sailors was opposed to co-operative organisation. In the herring fishery, however, there had long existed a system of control by representatives of the various fishing towns. This state of things, and individual competition, could not be maintained in the field of overseas trade, where in the last quarter of the 16th century Dutch traders played a growing part.

The first company trading to the East Indies, the Companij Werre, was created in 1594. Soon after some ten others were formed, six of them in Amsterdam. All were in keen competition with each other. The disastrous effects of excessive rivalry called forth within a few years a strong tendency to end competition by amalgamation. The six Amsterdam companies formed a union, but this was of no avail; the States-General had to intervene, and under their direction the Dutch East India Company was formed in 1602. This Company, unlike those created since 1594, the so-called *voor compagnien*, whose business was taken over by the new Company, had corporate status from the beginning.

Although the Company had a single capital, its business was carried on by six territorial chambers among which the capital was divided. They fitted out ships, bought goods for export and bore the cost of voyages. The ships had to return to their original ports of departure and to sell the goods there.

The Company itself, the central administration, supervised and co-ordinated the activities of the chambers. They could negotiate with foreign princes, build forts, equip troops, and so on. From the start the Company had not only the monopoly of trade with the East Indies, but some degree of governmental power with regard to negotiations with native princes, the erection of fortified posts, the maintenance of armed forces and the exercise of jurisdiction. The division of powers between the Company and the Chambers made management difficult. Each Chamber had its separate administrative body, consisting of the chief

participants, the so-called *bewinthebbers*, but the appointment of directors was until 1622 in effect in the hands of the provinces, and as regards Amsterdam of the City Council. The administration of the central organisation was entrusted to 17 Masters, and it was provided that although each Chamber paid dividends separately to its shareholders, these must always be at the same rate.

This complicated system of management could not have worked successfully if the Chamber of Amsterdam had not had a final power of decision, and if the chief participants had not been closely connected with the Government of the State. In the Chambers the *bewinthebbers*, and in the central body the 17 masters, had almost unlimited powers. For the individual rights of shareholders there was little protection. The amount of share capital was not fixed; in actual fact, however, the Company's capital of 6,000,000 guilders remained unchanged throughout its two hundred years' existence. But the shares were not equal. Thus in the Amsterdam Chamber the par value of some shares was 60, of others 60,000 guilders. Shares of 3000 guilders were common.

The shareholders were at no time liable to third parties for the Company's debts and obligations. The *bewinthebbers* were expressly relieved from liability in 1617. The separation of the Company's capital and assets from those of the shareholders was made clear from the beginning.

The original charter, which was for 21 years, was repeatedly renewed. In view of this short term it was provided that the shareholders might leave the Company after the first voyage; the accounts, however, were to be made up only after ten years. In 1611 certain shareholders did in fact demand the return of their shares, but this was refused by the *bewinthebbers*, who argued that a large part of the capital was sunk in fortifications, ships, arms, and munitions, and could not be repaid without detriment to the Company, and said that shareholders who did not wish to remain in the Company should sell their shares. It is clear proof of the power of the management that this view prevailed.

The original charter did not define the profits, and only in 1623 was it agreed that dividends were to be paid only out of profits. In fact dividends were paid out of the net balance in hand, and the strict notion of profits was never grasped or followed in keeping the books. The chief participants were the

only shareholders who could influence the appointment of *bewinthebbers*, and they were therefore in actual control of the Company. The whole structure was strongly aristocratic in character.

The East India Company was followed in 1616 by the Noordsche Company for the Baltic trade, and in 1621 by the West India Company. In the case of the latter political and military ends were strongly stressed from the first: 50 per cent. of the capital was provided by the State, and one of the 19 directors had to be nominated by the States General.

Neither in industry nor in other branches of trade did corporate enterprises come into being. Banking was dominated by the Bank of Amsterdam, a municipal undertaking which acquired a position of national and in some respects international importance. Shortly after the erection of the Dutch East India Company, however, its shares were dealt in briskly on the Amsterdam Exchange. These dealings, and those in certain State bonds, display quite modern features, with bull and bear operations, and the government repeatedly felt a need to take steps to prevent exaggerated speculation. The first prohibition of trade in futures in respect of East India shares was enacted as early as 1610.

Some moves towards the creation of corporate enterprises were made in France at the end of the 16th and in the first decade of the 17th century, mainly in connection with the colonisation of Canada and the West Indian islands. Companies were also formed in French ports for trade with Africa and the Levant. But these enterprises were short-lived and met with little success. They were not popular with French merchants, and Government interference was not fortunate.

As an outcome of the energetic policy of Colbert, the French East India Company was formed in May 1664 and the West India Company in August of the same year. These companies were granted exclusive trading rights, and Colbert took care to promote them by vigorous propaganda. But the response was unsatisfactory. The capital of the East India Company was intended to be 15,000,000 francs, but up to 1668 only 7,400,000 francs had been raised, and of this only 3,200,000 francs was met by private subscriptions. Most of the subscribers were aristocrats, courtiers and officials, particularly *intendants* and tax-collectors (*fermiers*). Even the judiciary, the *Parlements*, were induced to

take up shares; but mercantile circles were reluctant to take part. Despite all pressure, subscriptions, other than those of the Crown, by 1677 had hardly reached 5,000,000 francs. The position with regard to the West India Company was similar if not worse. Up to 1669 only 5,522,345 francs had been raised, and of this the King had contributed 3,026,545 francs. The amount taken up by merchants was insignificant.

These two companies were organised on similar lines to the Dutch East India Company, but Government influence was even stronger. Their affairs were managed as if they were Government departments. In another company, the New Guinea (1684), the King reserved the right to choose the shareholders.

By 1684 the original capital of the East India Company was lost. It was reorganised, but even so it met with little success. The West India Company could not maintain its monopoly against interlopers and foreign competitors. Its winding-up began in 1672, and resulted not only in the total loss of the capital but also in a substantial deficit, which had to be made good by the King.

The success of the Senegal Company, formed mainly for the slave trade, in 1673, and of certain minor ventures was small or even negative. The mercantile element in France was hostile to the companies and tried to defy their monopolies; French industry was carried on by individuals or family firms. The *Ordonnance* of 1673, the first French legislation on commercial matters, gives detailed rules for the *Société en Commandite*, but does not even mention companies.

SOURCES

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5. English Chartered Companies

England's trading and colonising activities were marked by the part played by private daring and enterprise. It was not the Government, but private adventurers, who took the initiative in seeking new sea communications. The organisers of merely

mercantile expeditions had to provide out of their own resources for the protection of ships and cargoes, and in repelling the Spanish Armada in 1588 armed merchant vessels and their crews took a prominent share.

Whereas on the Continent the Government had to bear a considerable part of the risks of trading companies and to subsidise them heavily, the English Government exacted financial help from them by way of loans. Yet the position of English commerce and colonisation in the 16th and 17th centuries was very difficult. England had not only to overcome natural obstacles, but also to compete for a place in the sun with the well-established maritime and colonial powers of Portugal and Spain, the ascendancy of France and the mercantile strength of the Netherlands. It was too hard a task for isolated entrepreneurs: united effort was essential.

True, there were the regulated companies. Nothing prevented their members from forming groups for special ventures, and this could also be done outside their ranks. Such groups were formed in the 16th century both for privateering and for ordinary mercantile expeditions.

The privateering ventures of Frobisher and Drake were undertaken by groups consisting of several capitalists and sailors. For example, merchants contributed to the capital of Drake's expedition of 1557, and took part in the venture with Queen Elizabeth, Drake himself, and his friends. The distribution of the profits was made, after the deduction of wages and of due provision for the refitting of the ships, in proportion to the contributions in vessels and crew.

The same practice was usual with wholly or mainly mercantile expeditions. Groups consisting of a number of merchants or other capitalists jointly provided the capital, both in vessels, wages and provisions for the crew, and the goods for sale or barter. After the expedition's return the goods which had been purchased or gained by barter were distributed or sold, expenses were defrayed, and the profit or loss divided in proportion to the share of each member. In some cases this was found not to be sufficient. The adventurers sought for a more stable form of organisation, and this took a new form—the incorporated joint-stock company.

Whether this evolved solely from English sources is a matter of dispute. There is much to be said in favour of this theory; on

the other hand, to assume that they had not heard of the Casa di San Giorgio and similar institutions would be to underestimate the knowledge and experience of 16th-century English merchants. In any case, in the second part of the 16th century this new form of organisation began to emerge in England. It is a company with a permanent existence, to which the members contribute the stock, which becomes the company's property; the trade is carried on by the company on its own account. So long as the company existed its members, the shareholders, could claim only an appropriate part of the profits, the dividend.

This definitive form, however, evolved but slowly. In many cases the company was only a framework, within which joint stocks were constituted for single ventures and were wound up after the ships had returned and the whole proceeds been divided. In this form the company was a transition stage from the regulated to the business company, the only difference being that the venture was carried on by the officers in the company's name and participation was free, depending only upon the contribution of capital, or at any rate was subject to far fewer restrictions than in the case of regulated companies.

Its emergence did not put an end to regulated companies. They struggled vigorously for survival, although in their old field their monopolistic rights were constantly being restricted and were eventually abolished. The Merchant Adventurers survived up to the 19th century, their post in Hamburg existing until the city was occupied by the French in 1807. The Russia Company also, formed in 1553 by London capitalists with a stock of £6000 for the opening-up of the North, and incorporated by royal charter in 1555, was after many vicissitudes converted into a regulated company in 1669. The same fate befell the Levant Company. After the grant of two charters, one in 1584 for the exclusive trade with Turkey, the other in 1583 for the monopoly of the import of currants, Candia wine and oil, it collapsed in 1588–9. In 1592 a new charter was granted, seemingly on a joint-stock basis, but in 1605 a regulated company was definitely established. The Eastland Company, incorporated in 1579 for the Baltic trade, was throughout its existence a regulated company. The various African companies alternated between the two types. On the other hand the East India Company, incorporated at the end of 1600, was always a joint-stock company, as was the Hudson Bay Company, formed in 1670.

It is usual to speak only of the companies for overseas trade as the first chartered companies, but at a very early stage joint-stock companies were formed for mining. The first were the Society of the Mines Royal, formed by indenture in 1561, and the Mineral and Battery Works, formed in 1565. Both companies were incorporated by royal charter in 1568 as "The Governors Assistants and Society of the Mines Royal" and "of the Battery Works" respectively.

In 1606 the first colonisation company on a joint-stock basis was formed, and was followed by a number of similar undertakings and land companies.

Industrial companies—outside the extractive industries—appear only after the Restoration, and the first incorporation of a water-supply company, the "Governor and Company of the New River brought from Chadwell and Amwell to London", took place in 1619. The creation of the Bank of England followed in 1694.

The formation of a joint-stock company with a corporate existence was held to require an act of the Sovereign, a royal charter. This was in accordance with the doctrine prevailing for all secular corporate entities.[1] The position was influenced by the question of monopoly. The foreign trading companies aspired to and were granted the right of exclusive trade, and many of the other companies enjoyed or sought some degree of monopoly. The strong feeling of Parliament and public opinion against monopolies extended to companies. Coke held that monopolies granted by the King without the consent of Parliament were void at common law. This was enacted in 1623 by the Statute against Monopolies.[2] The Crown maintained that the Act did not apply to trading companies, and its provisions afforded some basis for this view; but Parliament finally prevailed, and although the charter of the East India Company was repeatedly renewed without Parliamentary assent and its validity unsuccessfully challenged,[3] in 1698 the settlement was made by Act of Parliament.[4] The charter of the Hudson Bay Company was confirmed by Parliament in 1690.

The legal position thus was that whereas the creation of companies was covered by the royal prerogative, and the issue of a charter was required even if an Act of Parliament authorised

[1] See §§ 2 and 3. [2] 21 Jac. I, c. 3.
[3] East India Company *v.* Sandys, State Trials X, pp. 372–554.
[4] 9 & 10 Will. III, c. 44.

the issue, the Crown could not by the charter confer any monopoly for which Parliament's assent had not been obtained.

The agreement of the prospective shareholders to form a company was not, of course, sufficient in itself. Unless a charter was obtained and the company incorporated, its position was that of a partnership.

In the case of the early chartered companies the number of shareholders was small. We have examples of companies whose capital was divided into 30 shares. Those who embarked on the formation of companies seem as a rule not to have wished to secure the co-operation of a great number of persons. Even when a need for additional capital arose, this was procured not by the issue of additional shares but by calls; i.e. the shareholders had to increase their contributions, and the splitting of shares was common.

The idea of the corporate entity evolved so rigidly that no liability on the part of the shareholders for the company's debts was considered possible. As a result it was held that if a company became extinct and its reserves exhausted, creditors could not maintain actions against the shareholders. On the other hand the company itself could make calls and request additional payments in excess of the par value of the shares.

Under the influence of the doctrine of perpetual succession it was held that a company's existence cannot be subject to a time limit. A company was "immortal", as Coke said. But Acts of Parliament frequently limited the charters whose issue was authorised.

A company once incorporated, whatever its purpose, was held capable of any contract. Restrictive provisions in the charter were considered inoperative. The Crown could of course make the Charter forfeit in the event of its violation and dissolve the company; but the validity of contracts would not be affected. In the case of statutory companies, i.e. those created by Act of Parliament, the opposite was held.

There was no general law for corporations. Each was governed by its own charter according to its special circumstances and requirements. Some features, however, were typical. At the head of the company there was always a governor with a deputy, or two governors, as well as 12, 18 or 24 persons called at first assistants and later directors. All these officers had to be shareholders.

In the case of the earlier companies we know little about general meetings. At the beginning of the 17th century, especially in the case of the East India Company, general meetings took place for the election of the governor, his deputy and the directors, and for passing fundamental resolutions. There were also rules establishing a minimum holding as qualification for a vote, and limitations of voting rights. Thereafter general meetings are a regular feature of company life.

The autonomy of companies in regulating their organisation and activities gradually became recognised. They could enact by-laws within the limits set by the charter; by-laws containing provisions contrary to the charter were held void. The shares of chartered companies were transferable unless the charter prohibited transfer. Complaints of speculation—gambling in shares and stock-jobbing—appear frequently about the end of the 17th century.

To obtain a royal charter was no simple matter, and where the assent of Parliament was necessary the difficulties were even greater. It is therefore not surprising that in many instances joint-stock companies were formed without a charter. The shareholders formed the company by a deed establishing the capital and its division into shares. The company's organisation as to its governing body and general meetings was generally the same as with chartered companies. Shares could be transferred *inter vivos* or as hereditaments. In other words the deed provided that purchasers of shares, legatees or personal representatives of deceased holders were to be accepted as shareholders.

The unincorporated company was given a name in the same way as the chartered one. The governor and the directors or managers contracted on its behalf just as in chartered companies. There were, however, fundamental differences. A chartered company could sue and be sued. An unincorporated one had no *locus standi* before the court; the members alone could sue and be sued. Similarly the shareholders of an unincorporated company were jointly and severally liable for all the company's obligations and debts.

Surprisingly enough, in spite of these drawbacks quite a number of unchartered joint-stock companies existed. As long as they prospered, the difficulties could somehow be overcome. But if the venture failed, serious personal tragedies followed.

THE EAST INDIA COMPANY

The original charter of the East India Company was granted by Queen Elizabeth on 31 December 1600. The Company was granted a monopoly of the East Indian trade in both directions. The members incorporated by the charter numbered 218, and a capital of £30,000 was subscribed. But this stock had no continuity; it was subscribed for the first voyage only, and after the return of the ships the proceeds were distributed, and a new subscription opened for the second voyage. This close likeness to the regulated company was seen in other respects also; thus it was felt that the members should be merchants. Every member, apart from the subscription, had to pay a fee on admission, but for sons and apprentices of members this was merely nominal.

In one way alone was the Company's framework permanent: the list of members was fixed.

There was a permanent board, consisting of a governor and the usual 24 members; in this case it was originally called a Committee. The Company's working capital, however, had to be subscribed and paid for each individual venture which involved sending groups of ships laden with goods and bullion to the East Indies. This system, in spite of the great difficulties it involved, was maintained for 12 voyages, until 1613. Thereafter, to avoid these difficulties, a joint stock was formed for several voyages. The first of these joint stocks lasted for four years, the third (1632) until 1642, when the fourth was formed. Though this system was an improvement, difficulties remained. In 1633 five independent ventures in various phases were in existence simultaneously. It is a sign of the Company's conservatism that in spite of all the difficulties in management and accountancy the "New General Stock", namely a permanent capital, was not introduced until 1657.

The capital was fixed at £369,891, divided into shares of at least £100. In 1682 this capital was doubled by the issue of bonus shares. Beside the Company's capital and credit it constantly operated with large borrowed sums. The later issues of capital were made by public subscriptions, and the new funds mostly used to provide loans for the Government, of which there was constant need.

It was laid down in 1661 that the ownership of £500 stock gave a vote. To restrict the power of the large shareholders,

there was a movement to limit the maximum holding of a single shareholder to £1000. But this was not done, and we hear of individual holdings of £16,000 to £18,000. After a long struggle the charter of 1693 provided that in the case of large holdings there should be one vote for each £1000 up to £10,000, so that no shareholder should have more than ten votes. Many of the shares were held by foreigners, especially Dutch capitalists. The profits of the traders, and those of the Company after the formation of the permanent fund, were considerable, but varied according to the state of trade and the international situation. The operations and prospects of the Company gave rise to violent speculation, for the shares were transferable and the admission fee was greatly lowered so that it in no way hindered dealings in shares.

Provisions for rotation on the board, as adopted in the charter of the Bank of England, were never applied, and some governors and directors held office for long periods. The directors' fees were relatively small (£50). They were increased on the amalgamation to be mentioned shortly, but only to £150 yearly. Nevertheless the position of director was coveted; it afforded special advantages in trading, as well as opportunities for valuable patronage.

Although the Company's charter was renewed after the Restoration and maintained after the Revolution of 1688, its position was insecure. It had to face a great deal of hostility because of its monopoly. The "interlopers", the independent traders who attempted to do business direct with the East Indies, managed to win over a considerable part of public and Parliamentary opinion against it. The Act 4 & 5 Will. and Mary, c. 15, s. 10, imposed a tax of 5 per cent. on the value of its stock, the first quarterly payment falling due on 25 March 1693. The secretary of the Company postponed payment of the instalment until the last day, but that day was an official holiday and the Exchequer was closed. In consequence the Company's charter became subject to forfeiture. After lengthy negotiations the charter was renewed, but with considerable alterations.

Shortly after, danger arose from another direction. The Company's opponents, dissatisfied shareholders, interlopers, and would-be investors in the East India trade, began an agitation against it. But the result was not to set the trade with India free; by making use of the Government's financial need, the competitors secured a new monopoly for themselves.

An Act of 1698 [1] authorised the issue of a loan of £2 millions, the subscribers to which were to be incorporated in a general society for trade with the East Indies. This general society was to be a regulated company, with the proviso that its members were entitled to form one or several joint-stock companies. £1,662,000 of the loan was subscribed by a new company, the English Company for the Trade to the East Indies, £315,000 by the old Company, and £20,000 by independent traders.

The charter granted to the old London Company was to expire in 1701, after which the London Company was to have only the right to trade up to the amount of their share in the loan, i.e. £315,000. The English Company had no right to trade at all until 1701, but thereafter it might export up to a value of £1,662,000. But the trade was not extensive enough for this sum, and therefore the position of the English Company, in spite of the large amount it had lent to the State and the powerful patronage it enjoyed, was not a favourable one. Having no working capital, it had to secure funds by calls; furthermore, the trade could not be expanded sufficiently to produce favourable returns. These circumstances led in 1702 to an agreement between the two Companies which resulted in joint management and pooling of the trade—one of the first instances of a trading combination—and after 1709 they were completely amalgamated, the shareholders of both receiving shares in the United East India Company. This is the first known case of a merger in the history of company law.

The well-known events of the 18th century fundamentally transformed the Company's character. It became the centre of administration of a vast empire; its trading operations were thenceforth of secondary importance compared with its governmental and administrative activities. It came also more and more under the influence of Parliament and the Government. In 1814 it lost its monopoly of the East India trade, in 1834 that of the China and tea trades. As early as 1769 the maximum dividend was fixed at 12½ per cent. In fact, however, the Company was unable to pay this dividend, and lost much of its character as a profit-earning body. After 1834 its participation in trade and shipping became more and more insignificant, and after the Mutiny of 1857 it ceased to exist.

[1] 9 & 10 Will. III, c. 44.

THE HUDSON BAY COMPANY

The Hudson Bay Company is remarkable for its long life; chartered in 1670, it is still operating to-day. Its charter was a present to Prince Rupert, the Royalist partisan, who joined with 17 incorporators: these had to furnish the capital. Prince Rupert received bonus shares—to use a modern expression—and became the first governor of the Company.

The Company was partly a trading, partly a colonising enterprise. The chief attraction of the promotion was the fur trade with the Indians, and the Company was granted "the sole, exclusive right and fishery with and throughout the lands watered by streams flowing into the Hudson's Bay", and also received full dominion over these territories.

Commercially the Company enjoyed success from the beginning; posts were established and a brisk trade grew up. But it had to endure much from French competition and as a result of the wars with France. After the British conquest of Canada this danger passed, but Canadian traders replaced the French as competitors, and later formed the North-West Fur Company of Montreal. In 1821 the two companies amalgamated, and received an exclusive trading licence for the west and north-west hinterland of the old territory. This licence was prolonged in favour of the Hudson Bay Company for 21 years, but in 1859 was not renewed, and the Company's monopoly came to an end. Ten years later the Company surrendered its governmental rights and the territory of Rupert's Land, receiving compensation therefor, but retaining its trading posts as well as certain real property. A new life began under a régime of free competition, and especially from 1919 onwards the Company met with such success that both the volume and the profits of its trading greatly surpassed those of the period of its monopoly.

THE BANK OF ENGLAND

The Bank of England owed its foundation to a national emergency. The country needed money to carry on the life-and-death struggle with France and, after other schemes had failed, a plan was evolved to borrow £1,200,000 from such persons or bodies as were prepared to take shares in the Bank

of England in return. By 5 & 6 Will. and Mary (1694), c. 20, the Crown was empowered to appoint commissioners to take up subscriptions, and if the amount, or at least a moiety thereof, were subscribed, to incorporate the subscribers into "one body corporate and politick" under the name of "the Governor and Company of the Bank of England". The subscribers might be either British subjects or foreigners or corporations.

Each person or corporation might subscribe any sum up to £20,000, but until 1 July 1694 not more than £10,000. Since the whole capital had been subscribed by then, £10,000 was in practice the highest subscription. Actually the Bank had 1520 subscribers whose subscriptions ranged from £25 to £10,000, the average being about £764. On subscription 25 per cent. was to be paid in cash, and the remainder at call under penalty of forfeiture.

Under the powers given by the Act a royal charter was issued on 27 July 1694. This incorporated the subscribers into the corporate body of the Bank of England under the royal prerogative.

The money subscribed was to be lent to the Government. The sum of £1,200,000 was to be called and taken as the common capital and principal stock of the Bank, the sums paid by the subscribers representing shares in its capital.

The Act and Charter gave the Bank the character of a legal entity with perpetual succession and with capacity to acquire and hold any kind of property. But since the formation of the Bank was regarded as an emergency measure, its powers and capacities were subject to substantial limitations. Its privileges were to last up to 1705; thereafter the Government reserved the right to repay the amount after ten months' notice, whereupon the Bank's existence should "absolutely cease and terminate". The Bank was forbidden to lend any further amount to the Government without the assent of Parliament. Actually the loan of £1,200,000 was never repaid and the charter was from time to time renewed, generally with an increase of the loan and a corresponding increase of capital. In 1816 the capital was increased to £14,553,000 in connection with a new loan. The loan was at interest, and at first several specific State revenues were set aside for its payment. In course of time these provisions became obsolete, and the interest was charged to the general Budget.

It was intended from the beginning that the Bank's operations should not be restricted to lending the fixed amount to the Government, but that it should do other business. But here too there were noteworthy limitations. It was prohibited from all "trading in goods, wares or merchandise" except for the sale of goods pledged with the Bank as collateral for unredeemed loans, and for the sale of real property under the powers given by the Act and the Charter. Its business was restricted to the buying and selling of bullion and dealing in bills of exchange. Borrowing powers were also restricted, in the first place to the amount lent to the Government, and later to the amount covered by the subscriptions on the stock.

The Charter further provided that the shareholders of the Bank in general meeting, called the General Court, might make by-laws. The original by-laws were accepted by the General Court on 25 December 1694. These by-laws might not contain provisions contrary to the Charter.

Foreigners made considerable use of the possibility of subscribing and of becoming shareholders in the Bank, and for a fairly long period foreign persons and bodies retained substantial holdings. The shares were transferable, and the Charter provided that the Bank must keep a transfer book for registration of the original and later shareholders.

From the start lively dealing in the shares took place, with violent fluctuations of price, and they were objects not only of investment but also of speculation. These speculative transactions were fairly extensive, and we learn that in 1695 Sir Charles Duncombe sold £60,000 nominal of bank stock. Since his name does not appear in the Bank's books, he must—if the story be true—have acted through stockbrokers or nominees, in which case the use of nominees is not of such recent origin as is generally supposed. These speculations led to the provision of 8 & 9 Will. III, c. 20, s. 34, that sales and agreements for sale of the Bank's shares should not be valid unless registered in its books. In course of time, as the Bank took on the character of a permanent national institution and foreign stockholders gradually disappeared, the holdings became more stable, and in 1913 the Bank had 12,804 and, in 1944, 17,025 stockholders with an average holding of about £1161 and £859 respectively. No later data as to dispersal of ownership have been published.

For the management of the Bank's business there were a

Governor, a Deputy Governor and 24 Directors, these constituting the Court of Directors. Both Governors and Directors were to be British either by birth or naturalisation. They were to qualify for office by holdings, in the case of the Governor of £4000, in that of the Deputy Governor of £3000, and in that of the Directors of £2000 each. These provisions remained valid until the Bank was nationalised in 1946.

It was obvious that the Bank needed a regular staff to carry on its business, but the leading power and direction were meant to be vested in the Court of Directors, and although in course of time the staff of the Bank greatly increased (it has to-day some 4000 employees), yet on the whole not only the determination of policy but also the main executive direction are concentrated in the hands of the Court of Directors to a far greater degree than is the case with other great corporations. But a main idea of the Act and of the Charter was that the Bank should not be an instrument in the hands of a small clique, and it was therefore provided that election of Governors and Directors should take place yearly, not more than two-thirds of the retiring Directors, that is, 16 out of 24, being eligible for re-election. This provision was strongly resented by the Bank. But not until 1872 was this quota raised to seven-eighths, or 21, and the restriction was finally abolished only in 1896.

In respect of the Governors there was no such restriction. But in practice the Governor and his Deputy were elected from among the Directors, and as a rule a Governor could be elected only after having served for two years as Deputy Governor. After two years as a Governor he had to retire, but in several instances ex-Governors subsequently served as Directors. Apart from the period of formation, when the Governor served for three years, and during the war of 1914–18, when the then Governor had a service of five years, there were only two exceptions: in the 18th century Sir Richard Heathcote was re-elected after an interval for a second two-year period, and from 1920 until 1944 Mr.—later Sir—Montague (Lord) Norman was re-elected continuously for 24 years.

The two Governors and the Directors were required to declare on oath that they held the necessary qualifying shares in their own right, and that they would perform the duties of their office to the best of their skill and ability. All dealings with the Bank in which they were interested must be disclosed to the Board or

the Committee, failure to do so being made a ground of disqualification for office.

Although the Court of Directors was intended to meet once a week, it immediately became clear that it would not be advisable to deal with all matters in full session, which required the presence of at least 13 members, including one of the Governors. The original Charter therefore provided for the formation of committees or sub-committees of the Court. The most important of these were and still are the Treasury Committee and the House Committee. Beside these, special sub-committees were appointed on various occasions to deal with special matters.

The Charter provided that the fees of Governors and Directors were to be fixed by the General Court, i.e. the shareholders in general meeting. The first resolution fixed the annual fees of the two Governors at £200, and those of the Directors at £150. These amounts remained unchanged until 1804, when they were doubled, becoming £400 and £300 respectively. The next increase, raising the salaries of Governors to £1000 and those of Directors to £500, was not granted until 1882. Ten years later the salary of the Governor was increased to £2000 and that of the Deputy Governor to £1500. No later information has been made public, but it would seem that these disproportionately low salaries have now been substantially increased.

The General Court had very wide powers under the Charter. It chose the Governors and Directors and at first even the staff, though the latter practice later became obsolete. We have seen above that salaries depended upon the resolution of the General Court; the payment of dividends also depended upon the shareholders' assent.

From earliest days only the shareholder with a holding of at least £500 had a vote, and to exercise his voting rights he had to declare on oath that his shares were held in his own right and not in trust for any other person. Each shareholder had but one vote whatever the amount of his holding.

The General Court was to meet four times a year. Dividends were to be paid half-yearly, and two of the General Courts were held to pass a resolution as to dividends. In course of time it became usual to hold only two General Courts each year.

By the Charter nine shareholders were entitled to demand the calling of a special General Court. Should the Governors not call a meeting within ten days, the nine shareholders had the

right to call it themselves on ten days' notice, whereas the ordinary meetings under the Charter were to be called at two days' notice. Voting at elections was in writing.

Both for elections and for other matters a ballot could be demanded. If the subject of the Special General Court was a complaint against one of the Governors or Directors, two meetings were prescribed: one for discussion, the other for resolutions.

The governing idea behind these provisions was that the Bank should not become the exclusive domain of a small clique; in practice, however, the General Courts usually accepted the proposals of the Court of Directors. Even the elections generally called forth no emotion, although on several occasions attendance was large and, in times when the Bank was in the foreground of political struggles, there were often contests. The original Charter contained a very interesting provision in this connection: the Governors and Directors were to refrain from influencing the elections under penalty of disqualification for office. It was later enacted that only shareholders of more than six months' standing should have voting rights; this amendment was strongly resented.

Save for elections, modifications of the by-laws, increases of loans to the State and consequently of the Bank's capital, the main business of the General Courts concerned resolutions on dividends. By the Charter dividends might be paid only out of profits, and if dividends were paid in violation of this provision the shareholders were under obligation to repay any amounts received in excess of profits.

Although on several occasions there were lively controversies, the Directors' proposals were invariably carried. After the establishment of a reserve fund (the "Rest") in 1722 the Governing Body followed a policy of keeping the dividends within certain limits, whereas before then the profits had been distributed in full, and consequently the dividend varied greatly. This naturally led to wide variations in the price of the Bank's stock.

There were frequent disputes over the reserve fund. Some shareholders pressed for its distribution to increase dividends. The Board opposed this, and its views prevailed. For a time the amount of the reserve was not even made known to the shareholders. But it is generally assumed that the Bank possesses undisclosed reserves for contingencies and in view of its commitments and that such undisclosed reserves are considerably greater than the declared amount.

Since the provisions of the Companies Acts do not apply to the Bank of England, it has not to comply with their requirements as to balance sheets; apart from the disclosures imposed upon the Bank as the central note-issuing institution, shareholders and the general public obtain very little information as to the exact amount of its assets and net profits.

THE SOUTH SEA COMPANY

In considering the evolution of English companies the case of the South Sea Company cannot be passed over. This most ambitious and unfortunate scheme collapsed mainly on account of its disproportionately small commercial basis.

Its creation, like that of the Bank of England and of the "New" East India Company, was due to the desperate state of the national finances. The large loans secured by the Bank of England and the two East India Companies were not sufficient to consolidate all existing debts. Moreover the prosecution of the war with France involved a vast expenditure which could not be met from revenue, so that the floating debt of the Government constantly grew.

After long deliberation, a scheme was submitted to Parliament in 1710 for consolidating the debts and converting them into the capital of a company which was to be granted a monopoly of the South Sea trade. On 3 May 1711 Parliament adopted the proposal, and the Charter of Incorporation was signed on 8 September of the same year.

The amount of debt to be converted was £9,471,325; in actual fact creditors representing the amount of £9,877,967 15*s.* 4*d.* subscribed to the stock of the Company, and assented to the conversion of their debts into its stock. In 1715 this amount was increased to £10,000,000 by adding the interest for the year 1711 and certain other sums to the stock.[1]

The South Sea Company's capital was considerably larger than the total capital of the Bank of England, the East India Company, and all the existing chartered companies together. But it had no liquid assets for its commercial purposes, which could be financed only by using the State debts as collateral for sums to be borrowed.

[1] Act 1 Geo. I, c. 21.

It is hardly to be supposed that the trade with the Spanish Colonies could ever have afforded the opportunity to earn such profits as would give an adequate return on the capital invested. The situation was even worse than it would have been without any commercial enterprise at all. In that case the Company would have had only the interest paid by the State as its income, but without any substantial expenses. The stockholders would have received the interest as dividend without much deduction. In that form the undertaking did not lack attractiveness: the various debts which were converted into the Company's stock had at the time of conversion a market value of about 70 per cent. The interest to be paid by the Government produced a yield of over 8 per cent. So the stock appreciated in a short time to its par value.

But the commercial side of the Company was very poor. Though its monopoly was strengthened by the Treaty of Utrecht in 1713, the Company could never make a success of it. This was due partly to the competition of interlopers and partly to mismanagement. The Directors, however, saw further potentialities in the consolidation of the debts, and in 1719 a further step was taken by the conversion of a loan of £1,746,855 into stock of the Company, which was correspondingly increased.

The example of the notorious French Mississippi Company induced the Board of the South Sea Company to embark on the ambitious scheme of converting the whole National Debt into share capital. The original idea was not only to consolidate all floating debt, but also to repay the loans made by the Bank of England and the East India Company, and in this way to secure the rights granted to those companies by their respective charters. In this the Company had no success: the loans were not included, but otherwise the scheme was accepted, and in 1720 by 6 Geo. I, c. 4, the Company was authorised to convert into its own stock the debts due to such creditors as might give their assent. The amount of these debts was about £26,000,000, and the conversion was very favourable for the State in view of the reduction of the rate of interest which was to take place immediately, and a further reduction to be made after 1727.

But this Act did not determine the rate at which the conversion was to take place. It was laid down that the debts should be converted at their nominal value or at any other fixed proportion into the Company's stock. The matter was left to the Company,

which could agree with the creditors at their mutual discretion. This loophole gave rise to speculation to an extent hitherto unknown. The Company had every reason to further such speculation, for it had spent a considerable sum in securing the sanction of Parliament, and this bribery could not be kept secret save by concealment and the refunding of the amounts by selling stock at inflated prices. The imagination of the general public was influenced by the constantly rising prices: each rise in the current price of the stock resulted in the Company's becoming enabled to acquire a larger amount of debts in exchange for the stock to be issued. It also had the consequence that the Company had a larger amount of surplus stock on its hands, since it was entitled to issue stock up to the nominal value of the debts.

Had the Company been content with the natural possibilities of the rise in the market-price of its stock, the speculative rise would have been a moderate one and the general public would have been spared its disastrous effects. But the Company was not satisfied with that course. Probably they could not have been, for the immense amount spent on bribery, roughly £1,500,000, could not be concealed without an artificial inflation of market prices. They therefore resolved to influence prices by giving loans to stockholders to a considerable amount. These loans had the astounding effect that the stock, quoted at 147 at the opening of the year 1720, rose by about June to 1050. By that time the Company had invested £4,500,000 in such loans. Its means were strained to the utmost; new loans could not be granted and the price began to sag. At this moment the Board declared that they would pay a dividend of 50 per cent. for the next ten years. Obviously the position had become extremely dangerous; but public confidence was shattered even more by the line of action the Company now took.

Parallel with the speculation incited by the South Sea Company, a great wave of speculation spread over the country; a surprising number of most fantastic schemes were promoted between September 1719 and June 1720. Professor Scott records 190 promotions with a capital exceeding the country's whole trading wealth. Parliament was aware of and anxious about the danger: there was an investigation which resulted in the Bubble Act, but this was not immediately enforced. Many companies had no charters; they were formed as joint-stock companies by deed. Whether at the time of their promotion they had applied

for charters or not, they were not incorporated. In other cases charters obsolete through non-user were acquired and used for purposes other than those for which they had been created. The new enterprises, however, attracted the eye of the public, and in the fever of speculation large amounts were subscribed and partly paid up by gullible persons. The South Sea directors thought this speculation unfavourable to the placing of the Company's stock, and began proceedings against some of the companies, challenging their corporate existence by writs of *scire facias*. This action had unforeseen consequences. Not only did the bubbles burst, but the public began to sell even South Sea stock, and in a very short time the price fell to the level it had reached before the bubble. On 13 December 1720 it was quoted at 125 per cent. It was only that small minority of stockholders who sold out in good time who could make profits, or even avoid severe losses. The greater part of the shareholders suffered immense loss, and those who had speculated in the stock by purchasing amounts in excess of their liquid assets lost all their possessions and became bankrupt.

The Government made great efforts to avert the calamity, and endeavours were made to induce the Bank of England to amalgamate with the South Sea Company and to take over all Government debts, and to exchange the South Sea stock for its own. These negotiations led to a preliminary, but apparently not a binding, agreement, and finally the South Sea Company came to a settlement with the Government and its own stockholders by which the worst consequences were averted. Part of the debt, £4,000,000 in amount, was taken over by the Bank of England. The remainder was held by the South Sea Company. A part of the surplus stock was used to compensate those stockholders who had suffered loss by converting their holdings in State debts into South Sea stock at inflated prices.

A consequence of the burst of the bubble was the prosecution of the directors and of some public officials, including the Chancellor of the Exchequer, who was impeached and found guilty. The acts of bribery came to light. The prosecution, however, yielded but little for the Company, though the directors lost practically all their assets.

The South Sea Company itself subsisted after this arrangement mainly to administer the public debt remaining in its portfolio. Its trade activities were no more successful after the crash than

before. The main privileges of the Company were surrendered by the treaty concluded in 1750 between England and Spain, and the Company received £100,000 from Spain in compensation. By this treaty its commercial activities came to an end, though the formal termination of its exclusive trading rights came about only in 1807. Subsequently the Company was wound up.

STRUCTURE OF CHARTERED COMPANIES BEFORE THE BUBBLE ACT

Whereas the early chartered companies were more or less closed ones, and the number of shareholders was generally small, with the East India Company and the Bank of England this was not so: their shareholders were numerous, and their stock widely dispersed. Both companies even had a fair number of foreign shareholders. The Bank of England had at its foundation many foreign shareholders with an aggregate holding of nearly one-third of the whole stock, and some of these held their shares for a considerable time.

As already stated, there was a prohibition against the holding of more than £10,000 by any shareholder, individual or corporate. In the case of the East India Company a similar prohibition was proposed, but not accepted, and we learn that there were shareholders with holdings in excess of £10,000, some even nearing £20,000. But on the whole there were many shareholders with small holdings in this case also.

Holdings in South Sea Stock were naturally very widespread, for every holder of State debts was invited to join the Company and convert his holdings into its stock, and many of the creditors responded to this invitation. The great speculative wave of the year 1720 brought with it many transactions in South Sea Stock, and more than 20,000 transfers are recorded to have been registered in the Company's books.

There is a strong assumption that at the beginning of corporate life the organisation of companies was democratic in basis, and the self-government of the shareholders was concentrated in the Committees. But neither in the case of the Bank of England nor in that of the East India Company can any evidence for such a state of things be found. The General Courts very seldom refused to accept the Board's proposals. It is significant that this course was followed in spite of the fact that in the case of the

Bank no shareholder could exercise more than one vote, and in that of the East India Company plural voting became very restricted at an early stage. On the other hand the voting shareholder had to own a minimum of £500 stock, and thus the small shareholder was deprived of a vote.

Another remarkable fact was the stability of the boards. There was a strong tendency to re-elect retiring directors up to the limit permitted by the charter, and to accept the recommendations of the board when filling vacancies.

Another interesting feature was the growing importance of committees. For carrying on day-to-day business the board elected a committee consisting of a small number of directors to assist the Governor and his deputy. As time went on, more and more power became concentrated in the hands of the committee, and although all chartered companies had a regular staff of employees, their competence did not extend to more than clerical work. All making of decisions, and what we understand to-day by executive work, was in the hands of the board or its committee.

In the case of the East India Company the position as to work done and business transacted at the stations overseas was naturally different. The presidents or governors and even the factors of smaller stations had wide powers. To exercise effective control over these officers and employees was very difficult. Actually many, if not all, of the Company's employees engaged in activities on their own account, being even forced to do so by reason of their inadequate salaries and the lack of security for their future. Even in the case of the Bank of England, though within much narrower limits, a similar state of affairs is recorded.

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6. The Bubble Act and its Consequences

The frantic speculation at the beginning of 1720 filled the Government and Parliament with apprehensions which were not relieved by the investigation that followed, for in the early months of the year the speculative fever grew even more severe. This evil was attributed mainly to the promotion of unincorporated companies, for many of which no applications for charters were ever made, as well as to the misuse of charters granted for quite other purposes. But speculative activity was not confined to such cases, and the boom was greatly enhanced by the policy of the South Sea Company, which after all was a company duly chartered under Parliamentary authority. It is both tragic and comic that the board of the South Sea Company and its protectors instigated the movement for legislative interference and restriction.

In these circumstances the Act 6 Geo. I, c. 18, was passed. It was not a thorough-going measure of regulation. Far from overhauling the conditions of incorporation, it reserved the Crown's power to create companies, and even authorised the incorporation of two insurance companies, the Royal Exchange and the London Assurance Companies, both of which still flourish to-day. The Act aimed only, as its preamble states, at suppressing the "extravagant and unwarranted practice of raising money by voluntary subscriptions for carrying on projects dangerous to the trade and subjects of the Kingdom". By this Act the following activities, unless specially authorised, are prohibited:

(*a*) Acting or presuming to act as a corporate body.
(*b*) Raising or pretending to raise transferable stock.
(*c*) Transferring or pretending to transfer such stock.
(*d*) Acting or pretending to act by virtue of a charter which is obsolete, or using a charter for purposes other than those for which it was granted.

The Act was to come into force on 24 June 1720, from which day any such undertaking or acting was held to be void, "deemed to be a public nuisance", and all persons lawfully convicted are to be liable to those fines, penalties and punishments to which persons convicted of common and public nuisance are liable, and are further to incur the penalties of the old Statute of Praemunire,[1] namely, outlawry and the forfeiture of all their property. Brokers dealing after 24 June in the shares of such companies are to lose their right to act as brokers in future, and to be liable to a fine of £500, half of which is to go to the informer. Exceptions were, however, provided for. No undertaking established previously to 24 June 1718 is to be affected by the Act, or obstructed in carrying on home or foreign trade.

The wording of the Act was extremely ambiguous, not making it at all clear what acts constitute "acting or pretending to act as a corporation". Further, it was doubtful whether the issue of transferable shares fell under the prohibition *per se*, or only if they were issued in connection with the raising of large sums by way of subscription. Lastly it was not clear whether all promotions of unincorporated companies were to be the subject of prosecution or only such as tended "to the common grievance, prejudice and inconvenience of H.M. subjects or great numbers of them in their trade, commerce or other lawful affairs". This ambiguity was plainly seen by the lawyers of the time, as has been shown by the painstaking research of A. B. Dubois.

Speculation passed its peak at the very moment when the Act came into force. Not until August 1720, by an Order of the 18th of that month, was it decided to proceed against promotions without charter, and by then speculation was already beginning to wane. As we saw above, this decision was partly due to the instigation of the South Sea Company, which acted as informer in *scire facias* proceedings.

Such proceedings were actually instituted in four cases only, and in none of these were the penalties provided inflicted. Only one case is reported in which the penal portion of the Act was applied: Rex *v.* Caywood.[2] In this case the promoter of the North Sea Bubble was fined £5 and imprisoned during the King's pleasure, but the further penalties of Praemunire were not invoked.

[1] 16 Ric. II, c. 5.
[2] 1 Stranger (1722), reported also as King *v.* Cawood (1724), 2 Raym. 1361.

What part the Act and its enforcement played in ending speculation is doubtful. It may be that the collapse was inevitable. It is certain, however, that incorporation became more difficult, and since the Act remained in force until 1825, and was even extended in 1741 to the American Colonies,[1] it was at least a retarding influence and corporate enterprise was "under the shadow of the Bubble Act".[2] But it would be wrong to suppose that this meant a complete standstill in the evolution of corporate enterprise. It was still possible to apply for charters, the chance that Parliament would grant powers of incorporation remained, and certain unincorporated companies survived. During the whole of the 18th century it was never decided whether unincorporated companies were illegal at common law as *mala per se*.

With the revival of economic activity there was a stronger incentive to form new corporations. Business circles were well aware of the advantages of corporate enterprise, such as continuity of existence, capacity to acquire and hold property, greater efficiency in management and transferability of shares. Use was made of the hostile attitude of public opinion and of the authorities to corporations by the opponents of the petitions presented, and the Law Officers strictly scrutinised new schemes on which their opinion was called for. It was assumed that the incorporation of a company would, were it successful, inevitably lead to a monopoly, while if it were not the public would be injured. The stock-jobbing argument was also brought forward, and it was asserted that unsuccessful companies would become "bubbles". In fact very few charters were issued during the whole century.

For canal schemes, on the other hand, which began to come into notice from about 1760 onwards, an Act of Parliament was needed, since the necessary land could not be acquired without one. Parliament was on the whole less rigid than the Government, and from 1759 to 1800 more than 100 companies were incorporated under Acts of Parliament, mainly canal and navigation undertakings. Thus a new type emerged—the statutory company.

An Act of 1793, 33 Geo. III, c. 54, made possible the incorporation of friendly societies for mutual relief and maintenance

[1] 14 Geo. II, c. 37. [2] Dubois.

in sickness, old age or infirmity with the intervention of the local authorities. Otherwise the legal position remained unchanged. A company, accordingly, could not obtain corporate status without a charter. Whereas economic needs demanded the creation of enterprises for which the partnership form was not adequate, applications for charters were often unsuccessful. In many cases the delay and expense of such applications were prohibitive, and incorporation was not even sought for. We know, however, that quite a number of unincorporated companies were created, and many of them became successful and prosperous. Thanks to the investigations of Dubois we have valuable information as to how such unincorporated companies were formed, and how they carried on business under the adverse influence of the Bubble Act.

The difficulties were indeed substantial. An unincorporated company could not sue or be sued. Its trustees could act only as partners or agents. The validity of agreements to take up shares was precarious, and the rights of shareholders were not guaranteed. Statutory regulation was of course lacking, nor could cases be settled under the Common Law.

It was owing to the skill of the legal advisers of the various companies that these difficulties were overcome. They framed the deeds of settlement in such a way that the structure resembled that of incorporated companies as closely as possible. In many cases these deeds restricted the transfer of shares or made it depend upon the assent of the company, so as to safeguard it against prosecution. In other cases the smallness of the capital was thought to warrant an exemption from the prohibition. There was also a standing clause in these deeds of settlement affirming the absence of any intention contrary to the Act. In fact the number of unincorporated companies constantly increased, especially in the field of industry, where but a small fraction of undertakings were incorporated.

In the first years of the 19th century economic activity increased, leading to a boom. From 1803 to 1811 the number of companies nearly doubled, though many perished in the crisis of 1808. During this boom many companies were formed, but few incorporated. The Law Officers maintained their attitude of opposition to incorporation. The case of the Globe Insurance Company is significant. In 1799 its incorporation was authorised by Act of Parliament, but no charter was issued. The Company

petitioned in 1806, this time for statutory incorporation, but again without success. Yet it was able to carry on its business.

Company evolution was especially remarkable in the field of insurance. Until 1800 there were only six life assurance companies, but in that year three new ones were formed, and eight more before 1808—all without incorporation. This could not have happened but for official toleration, and it is noteworthy that opposition to incorporation was in some cases based on the argument that the company was already operating successfully without it.

The success of the canal companies abated animosity only as regards navigation, town water supply and dock undertakings. Several petitions for charters were presented in connection with the introduction of gas for lighting, and the London Gas Light and Coke Company obtained its charter—though only after a protracted struggle—in 1812. Other companies, insurance companies in particular, had no success with their petitions, and industrial enterprises obtained charters only in isolated cases. On the other hand the legal insecurity of unincorporated companies was much emphasised from about 1808 onwards, and the Bubble Act, which had seemingly been in abeyance for a number of years, was appealed to once more.

In Rex *v.* Dodd,[1] proceedings were taken against a company for violation of that Act, and the Attorney-General contended that the creation of a company without incorporation was an offence at common law. The Court did not decide the question, and inflicted no penalty in view of the length of time that had elapsed since the prohibition was enacted. Similar cases were Rex *v.* Buck and Rex *v.* Stratton,[2] in the latter of which likewise no penalty was imposed, though the creation of the company was held to have been illegal. In Rex *v.* Webb,[3] the Court decided that no offence had been committed, in the absence of any special nuisance and because the transfer of shares was limited, no shareholder being allowed to hold more than 20 shares. In Brown *v.* Holt,[4] the Court did not find any violation of the Act. In Pratt *v.* Hutchinson,[5] the transfer of shares was dependent on the assent of the company, and therefore the company was held not to fall under the Act. On the other hand in Josephs *v.*

[1] (1808), 9 East 516.
[2] (1808), 1 Campb. 547–549.
[3] (1810), 14 East 406.
[4] (1812), 4 Taunton 587.
[5] (1813), 15 East 510.

Petner,[1] the Equitable Loan Bank was declared illegal because its shares were transferable without restriction.

The absence of incorporation was felt more and more. Despite all the clever work of company lawyers it was impossible to bridge some gaps. Real property could not be acquired or held by the company; it had therefore to make use of trustees in whom the legal title was vested. It has been stated repeatedly that trusts give every facility which is provided by the corporate device. It may be so; but experience has shown that it is a most cumbersome method, since the unincorporated company could neither sue nor be sued; the shareholders had to bring action, and those who had claims against the company had to sue its members. Only in isolated cases were suits in equity admitted against unincorporated companies or their officers.

On a strict view it could be held that an agreement to create a company without incorporation was void, and that therefore the shareholders could not be compelled to pay their contributions. Similarly it could be argued that a contract made on behalf of an unincorporated company was illegal and therefore void as against the third party with whom it was made; thus neither of them could recover. This doctrine was obviously preposterous in view of the existence of a large number of unincorporated companies, many of them sound, and undoubtedly fulfilling an important function in the national economy. A new business boom was needed to sweep away the obstacle of the Act.

After peace was restored in 1815 English economic life recovered very quickly; liquid capital accumulated and sought placement in profitable enterprises. Opportunity was found in the various branches of industry and communications.

Two lines began to evolve which were subsequently to absorb large amounts of capital: navigation and railways. The first railway company had been chartered in 1821, and about the same time steam navigation began. Both classes of enterprise needed capital which could not be provided by private individuals. In the sphere of industry the introduction of steam-driven machinery and mechanical equipment had similar consequences, although the part played by companies remained for a long time secondary.

Unfortunately no official statistics of companies are available either for the 18th or for the first quarter of the 19th century.

[1] (1825), 3 B. and C. 639.

There is, however, a compilation by H. English.[1] According to the data there given 156 joint-stock companies formed before 1825 were still in existence in 1827, their total capital amounting to £47,936,486. In this total were included 63 canal companies with a fully paid up capital of £12,202,096; seven dock companies with a fully paid up capital of £6,164,590; 25 insurance companies with a capital of £20,486,948, of which only £6,648,948 was paid up. We find further 16 water undertakings with a capital of £2,973,170; 4 bridge companies with a capital of £245,201 (£195,201 paid up); 27 gas companies with £494,964 capital of which £479,814 was paid up; and 7 miscellaneous companies with a fully paid up capital of £1,530,000.

The fact that the capital of the insurance companies was only paid up to the extent of 30 per cent. does not mean that they were not sound. It was usual to pay only a part of the capital of such companies into the company's treasury, the unpaid portion of the shares being a guarantee fund for possible liabilities.

The attitude of Crown and Parliament in respect of incorporations, however, did not materially change, and most companies remained unincorporated. Only in one respect was a compromise made. By 47 Geo. III, c. 30, the Globe Assurance Company was in 1807 granted the privilege of capacity to sue and be sued by and through its officers. In the same year seven other companies received the same privilege, and up to 1815 fifteen more; mostly insurance companies, but, by 54 Geo. III, L. and P., c. 46, only one industrial company. For unincorporated companies the situation remained both obscure and uncertain. The demand for the repeal of the Bubble Act grew in strength, until in 1825 the movement succeeded and the Act was swept away.

Before examining the Act 6 Geo. IV, c. 91, it is convenient to cast a retrospective glance at company matters as they stood during the 105 years of the Bubble Act's existence. The legal need for incorporation has already been explained. There was a difference between companies chartered under Royal privilege and those under the authority of Parliament. Of chartered companies it was always maintained that, once created, they were entitled to perform any act and to engage in any activity on the same basis as a natural person, provided such act was not inconsistent with a corporate character, such as acts involved in

[1] Cf. *English Joint Stock Companies for* 1827.

the relations of family life. The Crown undoubtedly had the right and the power to declare the charter forfeit if it was abused in any respect, particularly if the company engaged in some business which the charter did not authorise; but until such forfeiture the validity of the act could not be questioned. A company authorised or created by Act of Parliament was held to be empowered only to perform those acts which fell within the ambit of its purpose as defined by the Act. This doctrine had been stated by Lord Mansfield in 1786 in Kirk *v.* Nowill and Butler,[1] and was thereafter maintained. Limited liability was one of the attributes of a chartered company, and an extension of liability was held not to be prescribable either by charter or by the company's by-laws. It was held that only an Act of Parliament could impose such liability upon the shareholders of a chartered company, as was actually done in the case of the Bank of England [2] for amounts which were paid to shareholders without being dividends on profits, and also in that of the East India Company by 9 & 10 Will. III, c. 20. For statutory companies it was in the competence of Parliament to decide the question and extent of liability, though as a matter of fact for most of such companies limited liability had been provided for. The possibility of calls in excess of liability was still maintained, and in some cases shareholders were held to be under the duty to pay calls although their liability was exhausted by the payments already made. In some cases the obligation in respect of calls was expressly provided for or excluded; in others the charter provided that a liability for calls existed only to the extent of the original capital as fixed at the company's formation. In the case of the Chester Canal Company an additional call for 60 per cent. of the fully paid shares was authorised, and the call was subsequently raised to 80 per cent.

The Courts, as already noted, had little opportunity during the whole period to decide questions of company law; therefore no case law similar to that found in other branches of English law could as yet be evolved. The same is true of legal theory. There was practically no literature on company law; the general works which dealt with corporations had mostly public corporations, such as towns, guilds, etc., in mind. The same was true of the first monograph on corporations, published by Kyd in 1792. On the other hand there is much interesting material

[1] 1 Term Rep. 118. [2] 5 & 6 Will. and Mary, c. 42 and 8 & 9 Will. III, c. 20.

in by-laws, company records and opinions of lawyers, which has been collected with great care and attractively expounded by Dubois. His researches show that many problems which we look upon as quite modern had already arisen in the 18th century. Thus, in order to prevent reckless promotions and the placing of worthless shares, many charters prohibited share transfers until a certain time had elapsed from the creation of the company and the general public had had opportunity to become acquainted with the business and its outlook.

The question of interlocking directorates had already come up. Some charters forbade them, but in the absence of express prohibition they were held not to be illegal. Some charters, for example those of the Royal Exchange and the London Assurance Company, even prohibited the holding of shares in a rival company. Directors were occasionally said to be in relation of trusteeship to the company, although this question was not examined in detail.

In some of the charters the purchase and holding of shares by the company itself was forbidden; in the absence of prohibition it was held not unlawful. Even after the South Sea crisis, which was partly due to excessive purchases by the Company of its own stock, similar practices continued.

One of the main reasons for the Bubble Act was the abuse of charters for other purposes. Under the influence of the Act the doctrine of *ultra vires* appeared in the Scots case of Budd *v.* Fordyce.[1] The charters were beginning to deal in greater detail with company organisation, and by-laws supplementing the charters are frequent. It was constantly maintained that the company might enact by-laws only in so far as they were not contrary to the charter.

The question of the company's power to coerce shareholders indebted to it was for a time in dispute. But it was later held that the company might sue the shareholders and even attach their shares by way of execution.[2]

There were no general rules to govern the shareholders' obligations towards the company, and it was therefore held that they were fixed by the charter. In the case of default no other consequences could be drawn by the company than those the

[1] (1778), Mor. 8380.

[2] See Nakorwick *v.* Royal Exchange, 2 Equ. Ab. 8, and the Hudson's Bay Company cases, 2 P. Wm. 207 and 2 Equ. Ab. 122.

charter provided. The remedy was generally forfeiture. In most cases this was provided for in that the defaulting shareholder had to suffer cancellation of his share and its sale by the company; but the surplus of the purchase price, if any, was not forfeited. There were, however, exceptional cases in which a company had power to declare total forfeiture of the share, so that the shareholder lost the instalment already paid. From 1806 it became a standing clause that if the shareholder did not wish to pay calls, the shares were to be sold.[1]

No direct action lay against the shareholder at common law, since the premises of an action of debt were held not to be present. Some of the incorporating Acts, especially the Canal Acts, granted such powers to the company. Nevertheless, according to Dubois, the companies refrained from bringing action even in such cases. They threatened to make use of this weapon, but seldom did so.

The structure typical of earlier companies was on the whole maintained. The supreme authority was vested in the General Court (general meeting) of shareholders, who were frequently called proprietors. The management was entrusted to the Court of Directors; its chairman or president was in many cases still called the Governor. The general court dealt only with matters reserved to it by the charter or by-laws. Such matters were the issue of shares and bonds, the increase of share capital or of bonded debt, the acquisition by the company of its own shares, of real property, though sometimes only if this was of considerable amount, and of competing businesses. In exceptional cases, such as that of the East India Company, the appointment of employees receiving a certain minimum salary—in that case £100—was also reserved to the general court. The declaration of dividends was always within the competence of the general court, and, as we shall see presently, this was the main subject of controversy between directors and shareholders.

There were thus no rigid boundaries between the competence of the general court and that of the directors, and much depended on the actual controlling power of the latter. Complaints were often made that the directors influenced the general court, for example, by preparing house lists for general elections or by holding separate meetings with a clique of shareholders. In some cases, on the other hand, the general court appointed special committees either to investigate certain matters or to exercise

[1] E.g. Bristol Dock Company (1806); 46 Geo. III, c. 35, s. 3.

powers otherwise vested in the court of directors. In one case the directors of the South Sea Company declared that they would refuse to execute resolutions which they thought improper.

In the matter of voting rights there was little change. A certain minimum holding was generally required for the right to vote, and although larger holdings were held in principle to carry the right to more than one vote, the maximum vote was usually limited. It was held that shareholders with less than the minimum holdings might not attend the general meeting. Shares without voting rights are found in the case of the Sun Fire Office.

The prevailing view was that the shareholder must exercise his vote in person. In most cases proxies were allowed, but in the absence of such provision the shareholder had no right to appoint a proxy to vote for him. Attendance at the general courts was usually scanty. In the case of the great companies, such as the East India and South Sea Companies, when the subject of the meeting was of general interest, strangers would try to be present, and special measures had to be taken against their attendance and the consequent disturbances.

In the frequent disputes between directors and shareholders over dividends, the directors' view generally prevailed. In 1766 the general court of the East India Company defeated the directors and declared a larger dividend than had been proposed. This resolution led to Parliamentary intervention.

The companies' financial structure remained simple; the capital was generally provided by the issue of shares. Increases of capital by the issue of additional shares were common if the necessary funds could not be procured by calls on the existing shareholders. Issues below par occurred. Subscribers of additional shares were sometimes accorded other privileges also. The preference share appeared in the case of the Chester Canal Company, and sealed obligations and bonds also came into use. We find obligations with priority as against other creditors, and others without such preferential right. The earmarking of special assets as security is not frequent; in the case of certain canal companies, however, the appointment of receivers to collect tolls in case of default was provided for. Sometimes the right to borrow on annuities was granted.[1]

[1] See for the East India Company the Acts 6 Geo. II, c. 28 (1733), and 23 Geo. II, c. 22 (1750).

It cannot, however, be said that either shareholders or creditors were effectively protected. We have already mentioned the extraordinary steps taken by Parliament against the directors of the South Sea Company. In accordance with prevailing ideas on the duties of Government and the legislature, petitions for investigation of the management of individual companies were frequent and sometimes successful. Whether Parliamentary interference in exceptional cases was as valuable as protection by a general law may be doubted.

Some particulars are available as to the increasing dispersal of share ownership. Thus in 1793 the Ellesmere Canal Company had 1244 shareholders. In the Leeds and Liverpool Company 393 persons held 864 shares out of 2059; on the other hand 446 shares were held by 10 persons.

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7. French Companies and Company Law to 1807

The normal business association in France at the end of the 17th century was the partnership—the *commandite*, or the so-called *participation* or "sleeping partnership".[1] The *Ordonnance* of 1673 mentions no other form.

The companies created by royal Letters Patent, mainly for foreign trade, with far-reaching monopolies, were regarded on the whole as instruments of Government policy, a view strengthened by the Crown's substantial participation in them and the large degree of Government control.

A new stage was marked in 1716 by the formation of the Banque Générale, initiated by John Law. This was a bank of issue similar to the Bank of England, with a capital of 6 million francs, divided into 1200 shares of 500 francs each. A fourth of the nominal subscription was to be paid in specie; three-fourths might be paid in State notes. The Bank was empowered to issue notes, but was under obligation to repay on demand in

[1] § 4, p. 21.

specie at the value fixed at the issue and mentioned on the note. The issue was destined to redeem the State notes, and in 1717 the Bank's notes were made receivable for tax payments. The Bank was a success, and by the middle of 1717 the note issue had reached 60 million francs. Its success might have endured; but Law embarked on a very dangerous course.

In 1717 the Compagnie de Louisiana ou d'Occident was created to take over the Canada and Mississippi Companies and Law was able to obtain for it the tobacco monopoly. In 1718 the Banque Générale was transformed into the Banque Royale, its obligations being guaranteed by the King. In 1719 the Compagnie de Louisiana absorbed the Compagnie des Indes Orientales et de Chine, the reorganised French East India Company. These transactions led to a wave of speculation resembling that in South Sea stock at the same time (§ 6). This was incited by the grant to the Banque of the management of the Mint and of the farming of the national revenue coupled with the obligation to pay off the whole of the national debt. To achieve this programme the Banque Royale and the Compagnie were amalgamated.

But this amalgamation could not prevent the collapse of the speculation and the shattering of public confidence in both the shares and the notes of the amalgamated Company. In 1720 the value of the notes had to be reduced by 50 per cent., but this halving of the debt could not postpone the collapse, and the great venture became insolvent. The defects of the structure were like those of the South Sea Company: the absence of a sound trading basis, the over-valuation of the so-called credit fund theory, excessive speculation, and its promotion from the Company's resources. The results were perhaps even more unfortunate than what happened in England.

It might have been thought that the collapse of the Banque Royale and the amalgamated Company would restrict and slow down the evolution of joint-stock companies in France. Nevertheless, as the painstaking research of Professor Lévy-Bruhl has shown, after the middle of the 18th century, a fairly large number of joint-stock companies were formed.

Before the outbreak of the French Revolution there were a number of canals, mines, ironworks and foundries, glass and other manufacturing enterprises incorporated as joint-stock companies, mostly under letters patent. According to Lévy-Bruhl the grant

of a royal charter was not strictly necessary, unless the company aimed at a monopoly or some other franchise requiring the royal assent. But this does not seem probable, and it may be assumed that the companies without letters patent were looked upon as unincorporated companies. The government exercised no active control over companies after their charters had been granted.

Documents show that even under the *ancien régime* two types were in existence: the joint-stock company proper, later called by the *Code de Commerce* the *Société Anonyme*, and the partnership by shares, or *commandite par actions*. The latter is a combination of a *commandite* and a joint-stock company in the sense that one or several of the partners—the so-called *Gérants* (managing partners) —assume personal and unlimited liability for the company's debts and obligations, the others limiting their liability to the amount of their shares. It was formerly thought that this type of association was a creation of the *Code de Commerce.* The original acts of such companies as the Compagnie Rozelet, created in 1746, show that this was undoubtedly a *commandite par actions*; it had forty shares at 6000 francs, and two of the shareholders acted as managers with full liability.

The shares were generally issued in the shareholders' names. In such a case the transfer was to be made by formal declaration (*declaration de transfert*). There were bearer shares as well, although even with these mere delivery of the share certificate was held not to be sufficient, and a declaration by the transferor was required.

The management of the companies was mainly in the hands of directors. General meetings were known, but it was not usual to hold them annually, and in one case a company held no meeting for 13 years.

Thus the outbreak of the Revolution in France found, beside the large privileged companies, a number of fair-sized joint-stock companies and *commandites par actions* occupying a substantial part in economic life.

In 1791 the National Assembly adopted the principle of the right of free association, applying it to joint-stock companies also. The reckless speculation that ensued led to the revolutionary law of the Year II (1793) which prohibited the formation of new companies and ordered existing corporate enterprises to be dissolved. The Directory, however, reversed the policy of the Government in this matter also, and in the year IV (1795)

permitted the free formation of companies whether as *commandites par actions* or joint-stock companies. In fact, however, most of the large number of companies created thereafter were of the former kind.

Napoleon's plans of codification included the question of company law. Many experts urged that the formation of companies should be made to depend upon the Government's assent, even in the case of *commandites*; but full freedom of creation also had its defenders. The long-standing prejudice and animosity of French merchants against companies of any kind likewise found full expression. Eventually the *Code de Commerce* (1807) effected a compromise, requiring a charter only for joint-stock companies proper, while *commandites par actions* could be formed freely and without restriction.

Besides prescribing that joint-stock companies may be formed only with the Emperor's consent, the Code contains a short statement of general corporation law—the first codification of company law.

The joint-stock company is called in the Code the "Nameless Company", *Société anonyme,* because it is laid down that the name of none of the partners may be included in that of the firm, the company being always designated by the subject of the undertaking (§§ 29–30). In this connection it is interesting to note that the *Ordonnance* of 1673 had applied the term "*Société anonyme*" to sleeping partnerships or *participations*, because a sleeping partner was not and might not be named.

The Code accepts the principle of limited liability, prescribing that shareholders are obliged only to pay the par value of their shares, and incur no liability in respect of the company's contracts and debts. This principle was understood to be absolute, and the shareholders' liability might not be extended by the articles. The capital of the company was to be divided into shares of equal par value, the principle of equality extending also to parts of shares, if such were issued. Bearer shares might be issued, and could be transferred by delivery of the certificate. Otherwise the shares were nominative: their transfer might be effected by a declaration executed by the transferor and by recording the transfer in the company's register.

As to management the Code provided only that the company's affairs were to be managed by agents appointed for a fixed term, removable by the shareholders, paid or not by the company,

as the articles might prescribe. Thus the Code gave the shareholders very wide powers to fix their constitution according to their convenience.

The Emperor's assent was to be given as an act of administrative jurisdiction, or in other words after examination by the State Council (*Conseil d'État*). With respect to publicity, the Code required only that the constituent contract should be filed with the Court and the decree according assent attached to the contract.

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8. English Companies and Company Law from 1825 to 1844

Under the influence of the economic revolution, accentuated by the boom which began in 1824, powerful tendencies were working for the repeal of the Bubble Act, and some voices were even heard demanding a general Company law.

But there was strong opposition. Foremost in the anti-company ranks stood Lord Eldon, who held that unincorporated joint-stock business companies were illegal at common law, quite independently of the Bubble Act. He even intended to introduce a Bill prohibiting any transfer of shares before incorporation. But this was never done, and in spite of opposition the Bubble Act was repealed by 6 Geo. IV, c. 91, though that measure provided that actions already begun under the earlier Act were not to be affected by the repeal. In consequence there were still for a number of years cases based on the Bubble Act, and in some of them Eldon's view was adhered to. Thus a dictum in Van Sandau *v.* Moore and others,[1] and in Kinder *v.* Taylor,[2] declared the Real del Monte Company illegal.

In Duvergier *v.* Fellows [3] a bond given to secure payment of compensation for the formation of an unincorporated company was held not to be actionable. As a dictum it was said that the execution of a bond in such a case was tantamount to a presumption of power to act as a corporation, and as such illegal.

[1] (1825), 1 Russ. 471. [2] 3 (1825), L. J. Ch. 68. [3] (1828), 5 Bingh. 267.

Later, however, a more lenient view was adopted under the influence of the repeal. Thus in Walburn *v.* Ingleby [1] it was held by Lord Chancellor Brougham that there was no authority for the view that the Bubble Act was merely declaratory of the common law, and that to raise capital by the issue of transferable shares was not a nuisance at common law.

In Garrard *v.* Hardy [2] it was held that the raising and transference of stock in companies was not in itself an offence at common law; the usurping of a common seal would be an offence, but to assume the style and form of a company did not amount to "pretending to act as a corporation" (*per* Tindal, C. J.). Similarly in Harrison *v.* Heathorn,[3] it was held that the raising of transferable stock was not in itself a nuisance at common law; it was only prohibited by statute, and the use of the name Anglo-American Gold Mines, without the assumption of a common seal, was not conclusive of the fact that the partners pretended to act as a corporation. Thus the doctrine followed by Eldon was completely reversed.

The Act 6 Geo. IV, c. 91, was intended to facilitate incorporations by charter by providing that in future the Crown might impose liability upon the shareholder to any extent in the charter without a special Act of Parliament.

The boom of 1824 brought with it many new promotions. By April of that year there were already 250 applications for private bills of incorporation. In 1825 there were 297 such petitions; of these 104 were for waterworks, gas and similar enterprises (73 granted); 146 for roads, canals and railways (108 granted); 47 for other enterprises (11 granted). In 1826, after the crash shortly to be described, the numbers were respectively 68 (47), 105 (83) and 18 (6). There were also many promotions of unincorporated companies. In all 624 companies were promoted, with a nominal capital of £372,173,100. Speculation in the shares of these companies was very active, and during the boom many were quoted at prices well in excess of the amounts paid in. Thus promoters and others who could act on inside information were able to sell their shares at a substantial premium and to get rid of their commitments, which caused much bad feeling after the crash.

The appointment to the boards of influential persons without

[1] (1832), My. and K. 61. [2] (1843), 5 Man. and Gr. 471.
[3] (1843), 6 Man. and Gr. 81.

any professional qualification began to become common. It is on record that 129 persons were directors of more than three companies simultaneously, among them 28 members of Parliament. It was at this time that the name of guinea pigs came into use to describe decorative directors without financial or commercial knowledge or experience.

The warnings of Government, Parliament and Press were uttered in vain, and in full accordance with the Bubble of 1720 many fantastic promotions were launched, especially in South American mines. The London Stock Exchange warned its members as early as July 1825 against doing business in connection with speculative promotions.

The crash came at the end of 1825. Its impact was heavy. By 1827, of the 624 companies mentioned above, only 127 survived, with a capital of £107,781,600, and of this only £15,285,930 was paid up. The value of the shares, as recorded by H. English, represented only £9,303,950. At the same time substantial premiums gave place to heavy discounts. Even of these 127 companies only a minority were still surviving by 1843.

But there were some sound undertakings among the companies formed during the boom; thus the General Steam Navigation Company survived and St. Katherine's Dock was constructed. Of the eight insurance companies promoted, seven paid dividends, and the gas companies were on the whole successful.

The impression created by the crash was such that an investigation into company affairs was mooted in Parliament. But the motion succeeded in one case alone—that of the Argina Iron and Coal Mining Company. Many competent quarters believed that the day of companies was already over. So thought *The Times* of 14 September 1826. Hardly ever was a prognosis so erroneous. The crisis of 1825 retarded the evolution, but did not end it. After 1830 British economic life was in full recovery.

Meanwhile substantial legislative progress was made. By 7 Geo. IV, c. 46, partnerships with more than six members, and companies, were enabled to carry on banking business outside a radius of 65 miles from London. This Act marks the end of a long drawn-out struggle against the exclusive monopoly of the Bank of England and the beginning of joint-stock banking in England, which the Bank strongly opposed, whereas in Scotland joint-stock banks had long been in operation.

Although the Act contained no provision for the incorporation

of joint-stock banks, it provided that they might sue and be sued in the name of their public officers. Every joint-stock bank had to appoint its secretary or another of its officials as its public officer. Up to the end of June 1827 five joint-stock banks had been established under this Act. In 1834 a further step was taken by 3 and 4 Will. IV, c. 98, which enacted that any partnership or company might carry on banking business in London itself provided that it did not borrow on bills or notes on demand or at less than six months.

Shortly before this the Attorney-General gave an opinion that banking business without the issue of bills or notes on demand had never been forbidden at common law, and that the privilege of the Bank of England applied only to the issue of notes. Jeplin, a banker and an author of distinction, had already asserted in 1821 that joint-stock banking without the issue of notes was not illegal. The said Act gave a new impulse to the formation of joint-stock banks; whereas from 1825 to 1833 forty new joint-stock banks had been created, in 1834 eleven and in 1835 nine new joint-stock banks were formed, so that by 1836 there were sixty-one such banks, carrying on business through branch offices at 472 places.

Another Act, 4 & 5 Will. IV, c. 94, gave the Crown fresh powers with regard to new trading and other companies. The most important was that the Crown could now grant a company certain corporate privileges without incorporating it by charter. The Act's main purpose was to make it possible to confer the power of suing and being sued without a special Act of Parliament, as had been necessary hitherto. The grant, to be made by letters patent, was to be published in the *Gazette* with three months' notice; the letters patent were to be entered in the office of the Clerk of Patents and to be available for inspection. In accordance with 3 & 4 Will. IV, c. 98, the company had to name one or more of its principal officials to function as its public officer, through whom it could sue or be sued. In equity, however, any member, i.e. any shareholder, could be joined as defendant. Judgment in suits by or against the officers became valid as against members without the necessity of suing them separately. Nevertheless the liability of the shareholders was to lapse three years after they ceased to be members of the company. To make the change effective a return of members was to be made half-yearly.

It might have been expected that this enactment and the

economic evolution would have facilitated incorporations. This was not the case. Incorporation of companies by royal charter remained very rigid. The Board of Trade defined its policy by declaring that the grant of charters was considered advisable only in the case of an enterprise of hazardous character, as with mines, or where large capital sums were needed, as with railways, canals and docks, or lastly in the case of assurance companies, where the liability undertaken was too widespread to be incurred by individuals. From 1825 to 1834 out of 30 applications only six were granted, three of these with double liability. The issue of royal charters continued to be very restricted even after 1834. From 1834 to 1837 twenty-five applications were made, but only four granted.

Parliament was more liberal in the case of water and gas undertakings and other public utilities, and the beginning of the railway age was marked by a number of incorporations. At first only local capital took part in railway promotions. Members of the Stock Exchange and other capitalists began to be interested in railways only after the great success of the first railway companies. In the years 1825–6 eighteen railway companies were incorporated; five per annum from 1827 until 1835; twenty-nine in 1836, and fifteen in 1837. But numerous promotions came before the public previous to incorporation. The incorporation and regulation of railway companies was effected by private Acts. By degrees more and more detailed provisions were included in the Acts according to the particular needs of each enterprise. Limited liability, however, was a typical point: there were no railway companies without it.

It was the railway companies that made the preference share a normal part of company financial structure, though its first appearance has been traced to 1777. After 1800 it was sometimes used—mainly by canal and dock companies—in cases where expenses exceeded the preliminary estimates and new funds were needed during the construction. Railways, needing a fair time for the building of lines, stations, etc., found themselves even more often in need of supplementary capital. This was sought at first by way of loans, but so early as 1829 we meet with the issue of preference shares. From 1837 onwards it became a usual method of procuring additional funds. In that year the issue of preference shares covered only 3 per cent. of the total amount raised by shares and loans, but the part played by

such shares was increasing. By 1850 more than 100 railway companies had issued them, and in 1857 18 per cent. of the capital was raised by preference shares.

The legal basis for their issue was provided by the company's special Act. Under the Company Clauses Consolidation Act, 8 & 9 Vic., c. 16, it was doubtful whether a company had the right to issue preference shares without a special clause.[1] This question was settled only in 1863 by s. 13 (5) of 26 & 27 Vic., c. 118.

No definite line was taken as to whether preference should be perpetual or only for the period of emergency. Likewise it was doubted whether preference shares gave a right to the equity. The doubts whether preference shares were cumulative when this was not expressly laid down were solved by the judgment in Henry *v.* Great Northern Railway Co.[2] The legislature took the same view by the Act of 1863.

Some opposition was shown to preference shares; they were thought to encourage speculation. In some cases shareholders opposed them. Thus in 1848 the general meeting of the Shrewsbury and Birmingham Railway Co. defeated by only 6332 votes to 5401 a motion to prohibit a preference issue. But economic necessity was stronger than the opposition, and preference shares were in fact mostly offered to shareholders; only a smaller number were taken up by the general public.

Beside these varieties of companies some mining enterprises appeared. But incorporated mining companies represented the smaller part of the mining industry, and the corporate mines were not of the first class. Industrial companies played an even smaller part, except in the West Riding woollen industry.

One section of public opinion vividly felt the disadvantages of the procedure of incorporation, whether Parliamentary or by royal charter. The heavy expense was particularly a subject of complaint. The fees for a royal charter amounted to £402 or, in the case of a bank, to £935. The expenses of Parliamentary incorporation were even higher. Those of the North Midland Railway Co. are recorded as £40,588; of the London and Birmingham Railway as £72,688. At the same time there was still a strong prejudice against companies as such, and even more against limited liability.

[1] Cf. 7 De. G. and Mn. and G. 176/2 and 3 K. and J. 740.
[2] 1 De G. and J. 606 (1857).

A further partial reform was achieved by 1 Vic., c. 73 (1837), which empowered the Crown to grant to a joint-stock company without incorporation, any privilege that might be granted with it. This applied firstly to the right to sue or be sued in the name of one of the company's officers. The Act, however, reserved the right to sue any member of the company in addition to or apart from such officer. Furthermore the Act made it possible to restrict the liability of the shareholders. It required the execution of a Deed of Partnership in which were to be stated the name or style of the company, the number of shares and the names of two or more officers. This Deed was to be enrolled in Chancery, or at the General Registry in Edinburgh. Any change in membership was to be recorded within three months. Full publicity for the returns was provided for. Another innovation was that the liability of the members ceased on the return of the record of their relinquishment of their holding. In the case of chartered companies the Crown was empowered to limit the duration of the charter to any fixed term.

The financial crisis of 1837 caused no great hiatus in the evolution, especially as the building of railways continued. Otherwise the Act made no substantial change; during the years 1837–54, i.e. until the introduction of the principle of limited liability, its privileges were granted only to 50 companies.

Opposition to a general company law was still strong. It is significant that a Bill to amend the Act of 1837 was passed by the Commons, but defeated in the Lords, and that the Glasgow Chamber of Commerce presented a petition against the extension of limited liability.

The situation is summed up in the fact that in 1843 there were 947 companies in existence in England. Of these 224 were concerned with gas and water, 108 with railways, 51 with shipping, 72 with insurance, and there was but a relatively small number of industrial companies. No official sources indicate the amount of capital invested in companies; but a private estimate prepared by Spackmann [1] puts the capital invested in 612 companies (chartered, statutory and other) at £224,229,746.

Progress was not without its setbacks; there were many reckless and dishonest promotions. The great concern of the Government and Parliament led in 1841 to the appointment of a Select Committee on Joint Stock Companies, which sat for over two

[1] *Stat. Tables of the United Kingdom and its Dependencies.*

years, examined a large number of expert witnesses, and presented a report to Parliament, which in its turn passed the Act 7 & 8 Vic., c. 110 (1844).

The interference of the legislature was motivated by the large amount of capital invested in companies and the malpractices in promotions, against which it was intended to give protection by full publicity. On the other hand it was desired to overcome the unreasonable prejudice against companies, especially the bias of the Courts, which—according to a circular issued by two banks in 1840—resulted in the constant favouring of individuals in suits between them and the companies. Since this Act is the first general British company law, though it did not adopt the principle of limited liability, it is worth while to summarise its contents.

The Act did not apply to Scotland. It had no reference to chartered or statutory companies, and in regard to companies whose purpose was an enterprise for which Parliamentary assent was necessary, it applied only with certain qualifications. Lastly, it was not intended to affect the position of those companies to which certain privileges had been granted, especially that of active and passive suability. This significant trait of British company legislation, that the position of companies chartered or created under previous legislation is not affected by the new law, appears for the first time in this Act and has been constantly maintained until to-day.

The provisions of the Act were to apply to any company formed for commerce or any purpose of profit with a capital divided into shares, to every assurance company, and to every partnership with more than 25 partners, provided it had a capital divided into shares which were transferable without express consent of the partners. For joint-stock banks a special Act was enacted on the same day, 5 September 1844.

The Act provided that before appealing to the public, the company must obtain provisional registration. For this purpose an application is to be made to the Registry of Companies, in which the name or style of the proposed company, its purpose, the names of the promoters, the members of the committee and the subscribers with the amount of their proposed participation are to be stated. Together with the application, the prospectuses or circulars are to be submitted. Failure to make application for provisional registration involves a fine not exceeding £20.

The Registrar of Companies is to examine the application, and if it is found in order a certificate of provisional registration is to be issued.

The effect of *provisional registration* is that the company is allowed to open subscription lists, to allot shares, to accept payment of an earnest of not more than 10*s*. per £100, i.e. ½ per cent., but not to make calls or contracts for the company. Not even the making of contracts of employment is allowed. In the case of companies whose objects require Parliamentary assent the earnest may be any larger amount provided by the Standing Orders of the two Houses of Parliament, and the company is allowed to make surveys for its proposed enterprise. In all these acts the proposed name of the company may be used with an affix stating that it is provisionally registered. Promoters or other persons violating these provisions are liable for contracts; in addition they are to be fined. The effect of the provisional registration and the powers thereby conferred last for twelve months, but this period may be extended.

In order to start business a *complete registration* must be obtained. This firstly requires the execution of a Deed of Settlement, containing: (1) Name or style of the company; (2) its business purpose; (3) the address of the principal office and branch offices, if any; (4) the proposed and additional capital, and if the capital does not consist in money, its nature and value; (5) the amount of borrowing; (6) the amount of shares subscribed or proposed to be subscribed at the date of the deed; (7) the division of the capital into shares, which are to be distinguished by separate numbers in regular series; (8) names, occupation and places of residence of the subscribers; (9) number of shares held by each, their distinctive numbers and the payments made; (10) names of directors, trustees (if any) and auditors, their occupation, places of business or private residence; (11) duration of the company and the mode or conditions of its dissolution.

Together with the deed of settlement a covenant with one or more trustees is to be made for the payment and performance of other engagements contained in the deed. The deed is to be signed by at least a quarter of the shareholders, holding at least a quarter of the maximum of capital (proposed and additional), and further by at least two directors.

The deed is to be filed with the Registrar, who examines the document and notifies the directors of any defects. In such case

a supplementary deed is to be executed. If the original or supplementary deed of settlement complies with the requirements, the company is to be registered.

Companies with objects which require the assent of Parliament have to deposit all documents required by its standing orders. Any alteration in the deed and any further deeds are to be deposited with the Registrar. To ensure full publicity it is provided that all registrations may be inspected gratis and that certified copies may be obtained by anyone on payment of a moderate fee. For the same reason half-yearly returns of additions and changes in membership—in consequence of transfers of shares or of death—and changes of names of shareholders by marriage or otherwise are to be made, in all cases with their places of residence.

Since under the Act the shareholders are liable for the company, any member who transfers his shares may immediately request the registration of the change. Until registration the new shareholder has no right to vote or to receive dividends, and the old shareholder remains liable.

Every company has to make each January a return of registration, of which a certificate is to be issued.

Complete registration gives the company corporate status: it becomes a legal entity, it may use the registered name and possess a common seal. Within the limits fixed by the deed of settlement it may make contracts and acquire and hold personal property. Money may be borrowed within the limits imposed by the deed of settlement. After complete registration the company may issue share certificates and receive payments thereon. Furthermore it may call up the unpaid parts of the shares. It has the power to make by-laws and to alter them by resolution of a general meeting specially convened for that purpose. By-laws must not be contrary to the Act or to the deed of settlement.

The company must hold yearly regular meetings, and may hold extraordinary meetings when necessary. For the conduct and superintendence of the company's business at least three directors are to be elected for a term provided in the by-laws, but not exceeding five years. The deed may provide for their re-eligibility on retirement. The general meeting may remove directors at any time. As to other officers, their offices and appointments are to be fixed in the deed of settlement; power to remove them is vested in the general meeting.

The activities of companies whose purposes require Parliamentary assent are regulated by the Standing Orders of the Houses of Parliament; they may petition for incorporation by Act of Parliament.

No shareholder may exercise his rights until he has signed the deed of settlement and paid the calls. On compliance with these requirements he may be present at meetings, take part in discussions, and vote. Voting by proxy is generally admitted; it may, however, be excluded by the deed of settlement. Voting rights may be restricted, but not so far as to deprive the shareholder altogether of his vote.

The directors' powers include the conduct and management of the company's affairs and the appointment and removal of the secretary and other employees. They are to transact the affairs entrusted to them at meetings. They must appoint a chairman, and should he be absent from a meeting, elect another for that meeting.

The directors' powers may be restricted by the deed of settlement, but not to an extent which would involve direct action by the general meeting: the Act maintains the principle that shareholders should not act otherwise than through directors.

No purchase or sale of the company's own shares may be made by the directors, with the exception of shares forfeited for non-payment. No money may be lent to a director or other officer, except by authority of the general meeting. Furthermore, directors who are directly or indirectly interested in any matter should not vote thereon. Contracts with directors are to be submitted to the general meeting for approval and are otherwise invalid; only contracts made in the regular course of the company's business, such as assurance policies, contracts for annuities, for purchase of articles, and for services in the regular course of business and on regular terms are excepted.

Every director must hold at least one share in the company, his office terminating if he ceases to hold such share. Any defect in the appointment of a director makes it unlawful for him to act, but the validity of his acts as against third persons is not affected.

The Act sought to define the criminal responsibility of directors, declaring that non-feasance or malfeasance with intent to defraud the company or the shareholders is a misdemeanour; likewise the falsifying or mutilation of books or the making of erasures in them.

Every meeting is to be recorded, and the minutes signed by the chairman. They are to be entered in the book of minutes which is to be kept at the company's principal office and to be open for inspection by shareholders during reasonable hours. This right of inspection may be restricted by the deed of settlement or by the by-laws.

The company must keep books of account, and enter all its transactions therein. The accounts are to be balanced annually. The directors, or any three of them, must examine and sign the balance sheet, which is subsequently to be signed by the chairman. The balance sheet shall be "full and true". It shall be submitted to the general meeting, after being audited by one or more auditors, elected yearly by the general meeting. If no auditor has been appointed, the Board of Trade has power to appoint one until the next general meeting and to fix his fees.

The balance sheet, together with half-yearly periodical accounts, is to be handed to the auditors for examination. They have the right to inspect all books of account and registry for the year, and are to have the assistance of the officers and servants of the company. They are to make a report within fourteen days after the receipt of the balance sheet, and where they do not approve of it they are to make a special report. Fourteen days before the general meeting any shareholder may inspect the balance sheet and books of account, and may take copies and extracts. The directors may authorise inspection at other times also. The right of inspection may be restricted or denied by the deed of settlement or by the by-laws.

Apart from this right of inspection, the directors must send a printed copy of the balance sheet, the auditor's report and their own report to every shareholder at least ten days previous to the meeting. After the meeting the balance sheet and the reports are to be filed with the Registrar and to be there open for inspection.

It is provided that the company's contracts are as a rule to be made under seal and signed by two directors or by an officer specifically authorised by the board of directors for that purpose. Contracts not exceeding £50, and likewise contracts for services not exceeding six months and not involving more than £50, may be made by an authorised officer. Bills and notes need not be under seal, but are to be signed by two directors and countersigned by the secretary; endorsements may be made by any

officer authorised by the by-laws. Deeds, on the other hand, are always to be executed under seal and to be signed by two directors.

The by-laws made by the general meeting are always to be filed with the Registrar and are otherwise inoperative.

A register of shareholders is to be kept, showing their names and addresses, the number of their shares and the amounts paid. Every shareholder may inspect this register and obtain a copy for a fixed fee.

Certificates of shares are to be issued on demand. They must state the date of complete registration, the number of the share and the amount paid. They are to be issued under the common seal of the company, and are *prima facie* evidence of title, which, however, may be rebutted. The share certificate thus differs from the Continental type and is not a negotiable instrument; consequently its absence does not prevent disposal of the share. Worn-out or damaged certificates may be exchanged for new ones on surrender; in case of loss the shareholder may demand the issue of a new certificate. All this is to be done for a fee fixed by the Act on a moderate scale. The fact of the issue of new certificates is to be entered into the register of shares.

Transfers of shares are to be made by deed, which is to state the consideration paid. The company is to keep a register of all transfers, and the entry is to be endorsed on the deed. Until the transfer is registered, the new holder has no rights as against the company. Before full payment of the share no transfer may be made, but the deed of settlement may provide otherwise and authorise transfers of partly paid-up shares.

The Act modifies the Common Law inasmuch as it grants the company an action of debt for calls, based on the fact of shareholding and the maturity of the instalment claimed. The company may claim 5 per cent. interest from maturity of the instalment.

As stated above, the Act regarded publicity as the best means for ensuring honesty in company affairs. Beside the details to be registered it is provided that by-laws, in order to be operative, are to be made in writing, filed with the Registrar, and printed, and any shareholder may demand a copy. Any interested person may demand from the Registrar a certified copy of the by-laws, the deed of settlement or the list of shareholders, directors and other officers, and any shareholder may inspect these in person or by proxy.

As we have said above, shareholders of companies registered under the Act are liable without limit for the debts and obligations of the company. Consequently every judgment against the company is operative against all its shareholders, without any necessity to join them in the action or to initiate new proceedings against them. An execution based upon a judgment against the company requires, however, the leave of the Court, which is to be given only after execution against the company has been found to be without result. Shareholders remain liable for three years after the termination of their ownership and its registration. Shareholders who have been compelled to pay debts of the company may request reimbursement from the company and contribution from other shareholders. By these measures the Act restricted to some extent the dangers of unlimited liability, but did not remove them, especially in the case of a company's total collapse, such as occurred in the times of commercial crises.

False claims that the company is under the patronage of opulent or eminent persons, and false statements as to the holding of directorships by such persons, are prohibited under pain of fine.

The Registrar of Joint-Stock Companies is to present an annual report to the Board of Trade regarding all companies and changes therein, which will be laid before both Houses of Parliament.

The Act 7 & 8 Vic., c. 113, passed on the same day, to regulate joint-stock banks, provided that such banks may in future be created by Letters Patent. The incorporation may be effected by petition to the Board of Trade. The companies must have a capital of at least £100,000; the shares a minimum par value of £100. Before incorporation at least 50 per cent. of the capital is to be subscribed and at least 10 per cent. thereof paid up. The company may not begin business without full subscription of the said capital and payment of at least 50 per cent.

A Deed of Partnership is to be executed and presented. Nine shareholders holding at least 21 shares have the right to request the calling of a general meeting. One-fourth of the directors are to retire yearly, and no re-election is allowed for at least twelve months.

The company may not purchase its own shares, or lend any money on their security. The banks must publish a monthly statement of their assets and liabilities. The balance sheet is to be audited yearly by two or more auditors. Beside the board

of directors a manager is to be appointed. The Letters Patent granted by the Board of Trade are valid only for 20 years.

The provisions of this Act as to the liability of shareholders are similar to those of the Joint-Stock Companies Act. The same is true as to the obligations of shareholders as against the company; the company is also given power to make calls and to enforce them by action of debt with 5 per cent. interest. This Act, however, also regulates the forfeiture of shares, which by the other Act was left to the company. Forfeiture cannot be declared until six months after the call was made. There must be a previous notice of 21 days given by letter, or if the shareholder's address be unknown, by insertion in the *Gazette*. Forfeitures must be confirmed in general meeting. No more shares than necessary may be sold.

Bills and notes may be signed by a single director or manager.

As to publicity, a memorial is to be registered at the Stamp Office which may be inspected by any person. All changes in the ownership of shares or otherwise, and all transfers of shares are likewise to be registered, and the record is to be open to inspection.

All joint-stock banks incorporated by Letters Patent under this Act have full corporate status, and not merely power to sue and to be sued, as under the Act of 1834.

SOURCES

D. C. Hunt, *op. cit.*
J. H. Evans, *op. cit.*
R. R. Formoy, *op. cit.*

9. English Companies from 1844 to the Introduction of Limited Liability. Evolution of Companies in Scotland

The legislation of 1844 made possible the formation of joint-stock companies as independent legal entities by registration without compelling them to adopt the expensive and hazardous method of seeking incorporation by charter, letters patent or special Act of Parliament. Nevertheless, these other methods remained open and in many cases were still resorted to. Furthermore, for railways and similar enterprises Parliamentary incorporation, or at least Parliamentary assent, remained a necessity.

Those who prepared and passed the Act of 1844, aware of the difficulties and dangers of corporate enterprise, were convinced

that the best protection for the public was the fullest possible publicity, extending to the auditing of balance sheets, while the best protection for creditors was the maintenance of the principle of the full liability of shareholders.

Under the new Act corporate enterprise was substantially extended, and the commercial crisis of 1847 interrupted it only for a short time. Between 1844 and 1856, when the principle of limited liability came into force, 956 companies obtained complete registration under the Act—910 in England and 46 in Ireland. Only a small fraction of these belonged to the industrial field. According to a table compiled by Shannon their distribution was as follows:

	English	*Irish*
Mines, coal and iron	16	—
Lead, copper, etc.	14	7
Quarries	11	—
Ore smelting and manufacturing	3	—
Railway rolling stock	7	1
Briquettes and coal by-products	7	2
Bricks, tiles and pottery	10	—
Coastal shipping	41	1
Ocean shipping	5	—
Telegraphy	1	—
Cotton manufacture	13	—
Woollens	1	—
Miscellaneous industries	18	—
Breweries	6	—
Other foods and drinks	24	1
Houses, land and buildings	29	2
Markets and public halls	85	1
Colonial gas and water	1	—
Colonial railways	10	—
Colonial mines and lands	28	—
Foreign gas and water	4	—
Foreign railways	2	—
Foreign mines and lands	29	—
Petty lending	29	—
Insurance	219	—
Gas and water	211	28
Railways	8	2
Other public utilities and works	13	—
Unclassified	46	1

Regarding the capital of these companies we have no exact data.

It will be remembered that railways could choose between registration under the new Act on compliance with the standing orders of Parliament, and incorporation by a special Act. Most of them preferred the latter alternative, i.e. they applied for

provisional registration only and then for incorporation by Act of Parliament. In the years we are considering there were about 1600 provisional registrations related to railway projects, whereas the number of incorporations by Act of Parliament, most of them railways, was 135.

The new companies were mostly connected with railways, so far as their capital, if not perhaps their number, was concerned. Capital investment in railways rose from £65 millions to more than £200 millions. These years are known as those of the railway mania.

As is shown by a comparison of provisional registrations with actual incorporations, there were many abortive projects. There were abuses too, but on the whole the railway companies were successful, some of them yielding substantial profits and paying large dividends.

Many of these companies were capitalised by subscriptions collected from provincial circles, and there were many small investors. We learn that at the end of 1845 there were more than 20,000 individuals with investments of less than £2000, their holdings amounting to £21 millions, and only 5000 whose investments exceeded £2000. All classes were represented among the investors.

The Legislature found it advisable to regulate statutory companies by two general Acts: the Company Clauses Consolidation Act of 1845, 8 & 9 Vic., c. 16, dealing with public utilities generally, and the Land Clauses Act of the same year, 8 & 9 Vic., c. 18, dealing mainly with the use of land and its compulsory acquisition by railway companies. Before this the special Acts incorporating each company had to provide for the regulation of the company's structure and the special powers needed for the undertaking. These two Acts provided a general framework for public utilities, and railways in particular. The former set forth a form of regulation very similar to that of the Act of 1844. Some of its provisions remained in force until 1946. Since the special position of railway companies is outside the scope of this work, we need not give details of the two Acts in question, nor of the similar legislation introduced in 1847 for Gas- and Waterworks, Harbours and Piers.

Lastly there were constant petitions for charters and incorporations by Letters Patent. The number of incorporations between 1837 and 1855 was about 100, out of 160 applications.

The attitude of the Board of Trade was still very unfriendly: many applications were refused to prevent speculation, others because they would interfere with private enterprise.

In spite of the substantial progress made, there were complaints regarding the regulations made under the Act of 1844. Some of its provisions were regarded as cumbersome, for example, that which required the registration of prospectuses; and a new Act, 10 & 11 Vic., c. 78, passed in July 1847, dispensed with this requirement. The same Act introduced some minor amendments; especially it made the authorisations to acquire land, which were within the power of the Board of Trade, easier to obtain.

Complaints were also heard regarding the system of dividing registration into two stages. In many cases promoters and subscribers paid the small earnest of 10*s*. per £100, and then used the scrip given them as receipt for speculative purposes, selling it, if they could, at a premium, and subsequently abandoned the project, so that complete registration was not proceeded with. In fact, of some 2500 provisional registrations only about 40 per cent. were completed. Between provisional and complete registration the future of the project was uncertain.

The main difficulty, however, was unlimited liability. The Act of 1844 took the view that incorporation could not be granted unless this was maintained. This view was opposed in many quarters, which looked upon unlimited liability as dangerous for the shareholders and a real obstacle to the creation of companies, even for the soundest undertakings. Money could not be found for honest and sound proposals, while capital remained idle or was directed into foreign companies, where limited liability was permitted. Capitalists took shares in foreign companies, in many cases of questionable character, with the result that investors suffered substantial losses. It was stressed that unlimited liability was not always, on the other hand, a protection for the creditor, though it meant the taking of disproportionate risks on the shareholders' part.

The effects of the crisis of 1847 made dissatisfaction with the existing law even greater; there were cases of the failure of companies with considerable deficits and consequent disastrous effects for the shareholders.

Many companies tried to meet the case by inserting clauses in their Deeds of Settlement providing that shareholders accepted

only limited liability. It was supposed that those who gave credit to the company after having notice of this clause could not assert unlimited liability against the shareholders. But before the Courts defences based on such clauses had no effect.[1] Doubts whether an express stipulation that unlimited liability would be excluded with regard to obligations arising from the contract would be operative were settled in the affirmative in Hallett *v.* Dowdall.[2] In some cases shareholders resorted to a clause in the Deed of Settlement prescribing that in case of losses the company was to be wound up before the losses absorbed its capital. Such a clause, however, could not have much effect.

The situation was aggravated by the unsatisfactory state of the common law as to partnerships. Not only were the partners jointly and severally liable for the partnership's debts, but also in every lawsuit the joining of all partners was held to be necessary, whereas if a partner paid on behalf of the partnership, he could not recover proportionate parts of the amounts paid by him from his co-partners. Business men and lawyers alike sought reform of partnership law, *inter alia* the introduction of limited partnerships (*Société–Commandite*). A draft Bill was even prepared on the instructions of the Board of Trade and a Royal Commission appointed to examine the question. But all these efforts remained unsuccessful, and the law of partnerships was not codified until 1890.

In 1854 a Royal Commission had been set up to consider company law reform. This Commission (the Royal Commission on Mercantile Law) heard 70 witnesses. Opinions were divided. According to Viscount Goderich 37 of the witnesses were in favour of the introduction of limited liability;[3] according to Shannon, only 15. The Government became rather reluctant, nevertheless Parliament accepted a Bill which became law as 18 & 19 Vic., c. 133 (1855).

On the whole this Act maintains the Registration Act of 1844, but declares that any company—other than insurance companies and banks—may be created with limited liability on complete registration, provided it has shares of not less than £10 par value and at least 25 shareholders who subscribe three-quarters of its proposed capital and pay up 20 per cent. of the

[1] See Sea Fire and Life Insurance Company, Greenwood's case, 3 De G. M. and G. 459 (1854), and Athenæum Life, 4 K. and J. 549 (1858).

[2] (1852), 18 Q.B. 2.

[3] Hansard, 1854, cxxxiv. 264.

amount subscribed. In such a case liability may be limited by express provision in the Deed of Settlement. Companies which avail themselves of this facility must not only state the fact in their Deed of Settlement but also include "Limited" in their name as its last word. Under similar conditions existing companies might reduce the liability of their shareholders to the par value of their shares.

In order to protect creditors it was enacted that directors declaring and paying dividends when the company was insolvent, or would become insolvent in consequence of such payment, are personally liable, save for those directors who do not take part in such declaration or payment of dividends, or who being present object to the payment and record their objection in writing.

Another provision was to the effect that shareholders' notes are not receivable in payment for shares, officers accepting such notes being liable for the amount concerned. Lastly directors were placed under the obligation to report if three-quarters of the capital were lost, in which case the company was to be wound up. In all other respects the provisions of 7 & 8 Vic., c. 110, were left untouched. Forty-six companies in all had been registered under this Act when it was repealed in 1856 by 19 & 20 Vic., c. 47.

This Act was the result of the strengthening of public opinion in favour of fuller freedom of incorporation. Its most significant feature was that the compulsory appointment of auditors was abolished. In Table B, containing the standard form of Articles of Association, it was provided that the company in general meeting shall appoint one or more auditors, but the contents of the table were optional just as Table A is to-day. The company could therefore exclude the application of this provision, and dispense with the appointment of auditors if it thought fit. It is curious that it was Robert Lowe, who in 1854 emphasised before the Royal Commission the necessity of full publicity as to accounts and auditing, who nevertheless as President of the Board of Trade introduced the Bill which dispensed with the compulsory appointment of auditors. Public opinion, however, was so strongly in favour of abolishing any restriction that the Act was passed practically without discussion.

The Act aims at a complete regulation of companies, save for the chartered companies and those created by Act of Parliament. It provides that seven persons may form a company

for any lawful purpose. Partnerships of more than 20 persons are to be registered as companies, all the partners being otherwise liable in full for the partnership's debts and obligations.

The Deed of Settlement is supplanted by the Memorandum of Association, which must state the name of the company, the part of the United Kingdom in which it will start business, its objects, the liability of the shareholders, i.e. whether unlimited or limited and, if the latter, to what extent, the amount of the capital and the number of shares. The word "limited" is to be used in the same way as under the Act of 1855. The Act forbids the use of names which are identical with or closely similar to those of existing companies.

There is no provision as to the minimum capital required, nor need any part of it be subscribed or paid up before registration. All that is necessary is for each of the seven persons who subscribe the memorandum of association to take up at least one share.

The company may draw up Articles of Association for the regulation of its affairs, and the Act contains, as above mentioned, a Table B, whose provisions are to be applied in so far as they are not superseded by other articles accepted by the subscribers. The memorandum of association and the articles, if any, are to be registered. On the submission of these documents the Registrar of Companies issues the Certificate of Incorporation. After registration the shares may be issued to the subscribers of the memorandum of association, and shares may be allotted to other persons willing to take them. The system of provisional and complete registration is abolished: there is only a single registration. With regard to the shares it is provided only that they are to be numbered and that they are personal property. The provision of the Act of 1855 prohibiting the payment of dividends in case of insolvency is maintained.

The company must keep a register of shareholders, and prepare an annual list with a summary stating the amount of the nominal capital, of the shares issued, of the calls, of unpaid and forfeited shares. A copy of this list and summary are to be submitted to the Registrar and may be inspected by any person. Only persons entered on the register are to be regarded as shareholders, and no trust may be so entered. Any person who complains that he has been wrongly entered or omitted is given a remedy in form of a summary petition to the Court of Chancery.

The register of shareholders may be inspected by shareholders without charge, or by others for a fee not exceeding one shilling. In accordance with the former Act it is also provided that calls constitute debts due to the company.

The company may carry special resolutions by a majority of three-quarters of the shareholders present, but such special resolutions are to be confirmed by a similar majority at a subsequent meeting within not less than one or not more than three months. An increase of the capital, however, may be authorised according to the provisions of the registered articles of association. If the company has less than seven shareholders and nevertheless carries on business as a company for more than six months, the shareholders are liable for all the debts of the company.

The Act has little to say on questions of management; this is in accordance with its principle of leaving full freedom to shareholders whether or not to accept Table B.

The formalities required for contracts are relaxed: deeds, contracts, bills and notes may be signed by any authorised person.

The only protection given to minority shareholders is that 20 per cent. of the shareholders in number and value of shares may apply to the Board of Trade for the appointment of an Inspector to investigate the Company's affairs. He may call for the production of books and documents, and has power to examine the officers on oath. His report is to be submitted to the Board of Trade, and to be forwarded to the company and also to those shareholders who requested the investigation. The requirement of 20 per cent. in numbers and holdings and the provision that all the expenses of the examination are to be borne by the petitioners obviously made this remedy practically inoperative. The further provision that the company itself might appoint inspectors had no special value, since under common law the power to inspect the books and accounts belonged to it in any case.

The Act of 1856 is the first of the Companies Acts to be extended to Scotland, and from then on the evolution of company law has moved on identical lines throughout Great Britain. It is therefore appropriate to glance at earlier developments in Scotland.

Scots law did not look upon joint-stock companies as illegal at common law. It was held legal to create such a company by contract, to raise a stock or capital divided into shares, to

stipulate for their free transferability and to entrust the management to directors or other officers. It was even admitted that a company might make contracts as a separate person and acquire personal property. Furthermore joint-stock companies could sue and be sued in the company's name with the addition of some of the directors, and there was no necessity to join the shareholders as defendants or plaintiffs in such suits. The company, however, could not acquire or hold real property, especially land, and had therefore to resort to trustees.

On the other hand the shareholders were held liable without limit for the obligations and debts of the company. The only case in which it was held that limited liability could be stipulated with force against third parties [1] was never followed.

The Bubble Act did not extend to Scotland and was never held to apply there, although its extension was argued in one case.

Besides the unincorporated joint-stock companies Scotland had its chartered companies. The Bank of Scotland had been created in 1695 by a special Act of the Scots Parliament. The Royal Bank of Scotland was created under royal charter, and the British Linen Company likewise obtained a royal charter in 1819, although Letters Patent had been already granted to it in 1746. All these companies were created with limited liability, and it has always been held in Scotland that limited liability is an incident of a chartered company.[2] Further, in the Sanders case [3] it was stated in 1879 by L. P. Inglis and L. Deas that the Crown had no power to charter a company with unlimited liability. Under the Act 6 Geo. IV, c. 91, two Scots banks were chartered with unlimited liability, namely the Commercial Bank of Scotland, which had been in business since 1810 without incorporation, and the National Bank of Scotland, created in a similar way in 1825. In both cases the unlimited liability resulting from the absence of incorporation was maintained. The three old chartered banks and the two new banks above mentioned established a large number of branches, and there were many unincorporated joint-stock banks whose activities extended throughout Scotland. In other fields of economic activity the number of joint-stock companies was relatively small, and as we have seen, the number of those which obtained incorporation either by charter or by Act of Parliament was even smaller.

[1] Stevenson *v.* McNair (1757), Kames' Select Dec. 191.
[2] *Per* L. P. Inglis (1878), 6 R. 401. [3] 7 R. 159–168.

LEGISLATION AFTER 1856

The legislation of 1856 was in some respects hastily prepared, and the Act had soon to be amended. By 20 & 21 Vic., c. 14, it was enacted that partnerships carrying on business without registration, though the number of their members was in excess of twenty, fall under the penalty that their members (shareholders) are severally liable for debts. In other words any partner or shareholder could be sued without joining the other partners or shareholders, and without previous execution against the assets of the partnership, i.e. the unincorporated company.

Another innovation of this Act was that companies were empowered to convert fully paid up shares into stock. Should a company avail itself of this permission the numbering of such shares was to cease; but the conversion was to be recorded with the Registrar, and the company was obliged to keep a register of the stock and its holders, which was to be open for inspection by shareholders and others.

In 1857 special attention was devoted to banks. The Act 20 & 21 Vic., c. 49, extended the provisions of the Act of 1856 to joint-stock banks. Consequently the requirements relating to the minimum capital, its subscription and payment were dropped, and seven persons on subscribing at least one share each of at least £100 par value could form a banking company. On the other hand it was provided that partnerships carrying on a banking business must register as companies if the number of their members exceeded ten. Should a banking partnership not be registered it is deprived of the right to sue and be sued; no dividends may be paid, and the directors are to be fined for failure to comply with the duty of registration.

Under this Act only one-third of the shareholders both in numbers and in holdings had the right to apply for examination of the affairs of a banking company. The principle of unlimited liability, however, was still maintained, in accordance with the views of some of the leading members of the banking profession. But this stage did not last long. The crisis of 1857 fell with special severity on banks, and a number of them carrying on large businesses failed. It was found that unlimited liability is neither a protection for creditors in case of failure, nor a factor which would make either creditors or shareholders cautious in granting and obtaining credits. At the same time the insol-

vencies of the banking companies in question inflicted many hardships on shareholders.

This led to an extension of limited liability for banks. By 21 & 22 Vic., c. 91, joint-stock banks were enabled to restrict their liability for the future, except for notes issued, with regard to which unlimited liability was to remain. Every banking company was empowered to alter its deed of settlement or articles of association accordingly and to re-register as a limited company, while new banks could be created under the amended Act of 1856 with limited liability. In actual fact banks refrained from registration or re-registration with limited liability. Especially was this the case with the leading London banks. This state of affairs remained in force until the Companies Act of 1862.

In the years between 1856 and 1862, 2479 companies were registered with limited liability. The returns prescribed by the Acts are not quite exact as to the capital of these companies; but it is stated on the basis of an exhaustive examination that those companies which still survived in 1874 had a capital of about £31 millions—only 16½ per cent. whereof was in companies in the stage of winding-up or dissolution.

An examination by Shannon shows that of these 2479 companies, after excluding abortive creations and small units, 1575 are left which were registered with limited liability. If we look into the field of operation of these, we find an increasing proportion of industrial companies. Thus 114 cotton, 3 woollen and 22 other textile manufacturing companies were promoted. Iron and coal promotions numbered 65; those for lead, copper and other mines, 207. On the other hand the number of water and gas companies was in decline. Another estimate by L. Levi for the same period shows 2631 companies with a capital of £185 millions, in which are included the railway companies incorporated by Act of Parliament.

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10. The Companies Act of 1862

The state of the law brought about by the various enactments of the years 1856–8 made the application of the Statutes by the Courts and the handling of company affairs by business men and lawyers a difficult matter, and there was urgent need of consolidation. This was satisfied by 25 & 26 Vic., c. 89, which came into force on 2 November 1862.

This Act, a comprehensive code of 212 sections with three schedules, is frequently described as the *Magna Carta* of company law, and a most accomplished example of legislation. If by this it is meant that the Act successfully consolidated company law the praise is well deserved. But a sober estimate of its provisions shows that it marked little progress by way of reforms previously unknown to English law, though many improvements and clarifications were achieved, and the principle of *laisser faire* in company matters was amplified. Many of the institutions of English company law had their origin in the legislation of 1855 and 1856, and even in the Act of 1844, although it is true that the Act of 1862 made the state of company law very clear and provided a simple method of incorporation and an elastic framework for the constitution and management of companies.

The principle that the liability of shareholders may be limited by the memorandum of association to the amount of the par value of their shares was fully maintained. Before this Act it was possible to form companies with unlimited liability or with liability in excess of the par value of the shares. The new Act, however, circumscribed in more detail a third type of liability, that limited by guarantee. This type arises when the shareholders are under obligation to contribute to the assets of the company in case of its liquidation for debts contracted up to the time when their membership, i.e. their ownership of shares, was terminated, and to the expenses of liquidation up to the amount fixed by the memorandum. The liability, limited or unlimited, ceases one year after termination of membership.

It is made clear that the memorandum of association can be altered only if it is so provided by the original regulation, i.e. the memorandum plus the articles, or by a special resolution in general meeting. The company may resolve upon an increase of capital, alter the division of the capital by converting the shares into new shares of larger par value, or convert shares into

stock. For the adoption of a new name not only a special resolution, but also the approval of the Board of Trade is required. For the articles of association the rule that Table A applies unless the shareholders in general meeting resolve otherwise remains unaltered. Companies with unlimited liability or with liability limited by guarantee must, however, adopt articles of association and file them for registration. Copies of the memorandum and articles are to be given to all shareholders on request.

The rule that no trusts may be recognised by companies and that registered shareholders alone are deemed to be shareholders of the company was maintained. This provision was not extended to Scotland, where companies could take notice of trusts of shares, and actually can do so even to-day. The rules as to registers of shareholders were supplemented by a provision that incorrect and omitted entries were to be remedied in England and Ireland by motions, or in Scotland by summary petitions.

In view of the widespread financing of companies by the issue of preferred shares and debentures with special security it was provided that companies must keep a register of mortgages and other charges, open for inspection by the company's shareholders and creditors, though not by the general public or by prospective creditors—a serious drawback.

Companies without shares were placed under obligation to register their directors. Why this provision was not applied to all companies is not clear; it is obvious that for companies with share capital such publicity is equally important.

The scope of this book does not permit of a detailed examination of the Act's provisions. Some reforms of more general character and interest must, however, be mentioned.

In the case of voluntary liquidation it was provided that an arrangement with the creditors will bind the company if it is made by an extraordinary resolution, i.e. by three-fourths of the capital represented at the meeting, and the creditors if three-fourths in number and value have assented to it. Any creditor or shareholder, however, was granted a right of appeal within three weeks to the Court, which might at its discretion amend, vary or confirm the arrangement.

An important innovation was the power given to the Court on the application of a liquidator, shareholder or creditor to investigate the conduct of any past or present director, manager, liquidator or officer of the company. Should it be found that

he had misapplied or retained, or become liable or accountable for, any monies of the company, the Court may compel him to repay the amount in question to the company with interest or to contribute to the assets, as it may think fit. The same was to apply in any case of misfeasance or breach of trust.

The Act made it possible for unincorporated companies to be wound up if they were dissolved, ceased to carry on business, or were unable to pay their debts, or in any case in which the Court should find it just and equitable. The voluntary winding-up of an unincorporated company, however, remained inadmissible. The main advantage for shareholders in an unincorporated company was that the Court had power to stay proceedings against both the company and the shareholders who had to contribute. In the case of voluntary liquidation this power did not exist.

The new Act gave a strong impulse to the creation of companies. Their promotion was in any case enhanced by the increase of liquid capital, as the country had now overcome the effects of the crisis of 1857.

In the years 1863–6, 3503 companies were registered with limited liability. During the same period 876 companies with a nominal capital of £373,230,050 offered to the public shares of the par value of £268,136,900. Of these 283 were manufacturing companies with a nominal capital of £84,700,000 and with shares to the amount of £64,902,900; 56 were banking companies with a nominal capital of £72,950,000, offering shares of £51,950,000.

New registrations in respect of certain old kinds of corporate enterprise were reduced to a quite insignificant role; on the other hand an entirely new type arose, namely, finance and discount companies. Over this period 50 of these companies were created with a nominal capital of £69,350,000, offering to the public shares of the par value of £45,750,000. Finance companies were introduced after the example of French finance companies, especially the Credit Mobilier. Their fate in Great Britain was likewise disastrous.

It is recorded that of the capital of the 876 companies above mentioned which offered shares to the public during the period in question, the amount paid by shareholders was £35,648,640, or not quite 10 per cent. of the nominal capital. Their financial basis, therefore, was not solid, and it is not surprising that many of them could not weather the storm.

This lack of sufficient foundation was most significant with regard to finance companies. Industrial companies on the whole had sounder foundations.

Another new feature was the conversion into companies of existing industrial establishments. A large number of these, mainly well-established ones, became limited companies at this period.

At the same time many new railway companies were formed, and existing ones constructed new lines. The total railway mileage at the end of 1865 was 14,289; the capital amounted to about £456 millions.

In 1867 there was a slump in commercial activity, and shortly afterwards a serious crisis developed. This crisis was made more severe by the failure of Overend and Gurney, a banking business with very extensive activities which had shortly before been converted into a limited company with wide applause from public opinion. But some opinions were more cautious, and competent observers issued warnings against the excesses of speculation, though on the whole with little result. The reverse experienced was very serious. Whereas companies registered in 1864 numbered 965 and in the following year 1034, their nominal capital amounting to about £235 millions and £205 millions respectively, the number of new registrations dropped in 1866 to 762 with a capital of about £7,400,000, and in 1867 to 479 with a capital of £31 millions.

Interference by the Legislature was urged, not, curiously, in the field of banking, where the most serious failure occurred, but in that of reform of company law. This demand was satisfied by 30 & 31 Vic., c. 131, an Act to amend the Companies Act of 1862. The reforms made by this Act were not without importance, though they fell far short of providing adequate means of preventing such abuses as had appeared.

The Act introduced a new type of company, similar to the French *Société par actions* (see § 7) and the German *Kommandit Aktiengesellschaft*. Companies might be created with limited liability for shareholders but unlimited liability for directors. Furthermore, existing companies were empowered to extend the liability of their directors from the amount of their shareholdings to an unlimited liability for all the company's debts. This liability, however, was to be asserted only in case of winding-up, whereupon the directors became contributors with unlimited

liability. This seemingly far-reaching reform remained a dead letter: not one such company was formed.

The Act made a reduction of capital depend not only on a special resolution in general meeting but also on an order of the Court, and creditors might object to the reduction. But the Court might dispense with the assent of objecting creditors, provided the company gave security for the debt. The Court was empowered to prescribe the affixing of the words "and reduced" to the name of the company for a certain time. It was likewise enacted that a company may by special resolution subdivide its shares into shares of smaller par value. Companies were also permitted to have fully paid and partly paid shares simultaneously. The Act moreover abandoned the principle that all the shares must receive identical treatment as to payment. Companies were given power to make varying arrangements with their shareholders as to both the amounts to be paid on the shares and the term within which payment was to be made.

Until the passing of this Act it was a constant principle of British company law that shareholders must be registered with the company and that share certificates must contain the shareholder's name. The Act introduced share warrants to bearer, i.e. certificates entitling the bearer to demand from the company the delivery of one or several shares. Such warrants were to be issued only for fully paid shares or stock. To make use of this facility the company had to insert suitable provisions in its articles. If the original articles contained no such provisions the company might insert provisions authorising the issue of bearer warrants by special resolution. The company could make these bearer warrants more than simple warrants for delivery of shares on request, for they could be provided with coupons entitling the holder to receive dividends. It even became possible to provide that the holder of a bearer warrant might exercise certain rights of a shareholder according to the provisions of the articles. In the absence of such provision the holder of a warrant had to demand the delivery of the shares it represented against its surrender and cancellation. At the same time the bearer's name must be entered on the register of shareholders and the share certificate issued in his name (re-registration). When bearer warrants existed under a company's articles it became possible to convert shares and stock into such warrants, or warrants into shares. Thus any company might simultaneously have registered

shares, registered stock and bearer warrants, and their proportions could be changed at the request and convenience of shareholders.

In order to protect subscribers, purchasers of shares, and shareholders, it was provided that any prospectus or any notice inviting persons to subscribe or to take shares should in future contain the dates of and the names of all the parties to any contract which before the issue of the prospectus or notice had been entered into by or on behalf of the company. Omission of these particulars was to be regarded as fraud.

Finally the Act of 1867, like nearly all Company Acts, contained amended provisions regarding winding-up proceedings.

The only provision which could be considered as aimed at protecting the public against fraudulent promotions was the compulsory disclosure of the names of persons involved in contracts with the company before the issue of the prospectus or notice of subscription and the dates of such contracts. These particulars are in themselves, however, fairly irrelevant if the contents of the contracts are not disclosed. Even so a method of evasion was devised by inserting in the prospectus or form of subscription a clause by which the subscriber waives such disclosure.

Suggestions for the amendment of the law of partnership met with some success in 1865 by the enactment of the rule that persons lending money to a single merchant or a partnership against a share in profits are not to be regarded as partners and incur no liability for the debts and obligations of the partnership. On the other hand they are not entitled to assert their claims in case of liquidation; in other words they rank behind creditors. This was in principle equivalent to the introduction into English law of the limited partnership, the *commandite*.[1] The expectation that by this reform the ascendancy of the device of corporate existence would be lessened was not realised.

When the crisis was over, the movement to extend corporate enterprise both by creating new undertakings of this form and by converting existing ones into limited companies became even more marked. On looking back we can see that in spite of all the difficulties and the harmful consequences of the recurrent crises, limited companies played an important part in the economic growth of the nation. The freedom and simplicity of

[1] Bovill's Act, 28 & 29 Vic., c. 86.

company formation obviously contributed to this result. Such freedom was felt to be on the whole beneficial to the country. Nevertheless it had its disadvantages also. One was the possibility of fraudulent promotions. The Act of 1844 aimed at full publicity; its authors believed this to be the sufficient and only way of protecting the public against fraud. The obligation to register the prospectuses, however, was abandoned after three years. The amendment of the Act of 1867 mentioned above was a poor substitute for registration, and, as the experience of the seventies showed, it did not provide effective protection.

Another awkward consequence of the growth of the company movement was the increase in speculation. In some influential quarters it was believed that bear selling of shares contributed in many cases to the fall of companies, especially of banks. In 1867 an Act, 30 & 31 Vic., c. 29, provided that sales of shares in banking companies should be void if the bill of sale did not contain the numbers of the shares. In this way the legislature thought to make the sale of shares which the seller had not in his possession at the time of sale impossible. But the Act was quite without effect.

An extensive examination over the period 1862–6 has been made by H. A. Shannon to discover what proportion of company promotions were abortive and what was the average life of companies formed. His results show that many companies never commenced business, a considerable number were but short-lived, and both shareholders and creditors met with substantial losses. Shannon concludes that the freedom granted by company law was of dubious value, and that it may be suspected that enterprises in company form were on the whole less successful than one-man undertakings or partnerships. But since no exact data as to bankruptcies are available this conclusion may be questioned, and the fact that after 1867 the creation of new companies not only increased parallel with the volume of national wealth and business but also invaded more and more new fields is on the whole a strong counter-argument.

According to an earlier review made by L. Levi, out of 7056 companies formed after 1844, 2974, i.e. about 42 per cent., remained in existence in 1868. The lowest rate of survival was in banking and finance; out of 291 there remained 49, i.e. 16 per cent., or 43 per cent. by volume of investment. Cotton companies show a resistance exceeding the average, with 117

survivors out of 215, or 54 per cent. Mines fell below the average, with 439 surviving companies out of 1419, or 30 per cent., and so did various manufacturing companies, with 352 survivals (34 per cent.) out of 1016. Professor Levi concluded, perhaps prematurely, that the business of the country was gradually passing out of the hands of private firms. At this time the statement was true as to industry only with qualifications and very slightly true as to commerce, where within our period only 539 companies were formed of which 193, i.e. 35 per cent., survived.

Although it would be an exaggeration to say that from the middle of the sixties corporate enterprise represented the greater volume of business, it is undoubtedly true that the part it played was a substantial one, and the growth of companies was closely connected with the extension and contraction of business due to the industrial cycle. But beside this there was a constant extension of the corporate system into fields which earlier had been dominated by one-man firms and partnerships.

In spite of this many onlookers thought that the heyday of the company was past. Thus one observer of profound knowledge and competent judgment, Goschen, stated in 1868 [1] that there was a general distrust of limited companies in banking, finance, industry and commerce, and in railways as well. But events disproved this gloomy view in the very next year. In 1869 there was a revival: the nominal capital of new companies registered rose to £141 millions, and even if we deduct one promotion with a nominal capital of £100 millions which could not be regarded as real, since only £200 was taken and paid-up, the rise is still a substantial one.

The rise in registrations was constant. Thus in 1873 new companies were registered with a nominal capital of £152 millions.

In the field of legislation the method of introducing partial reforms according to experience and urgent needs continued in force. In 1870, by 33 & 34 Vic., c. 104, arrangements between creditors and shareholders of insolvent companies were facilitated by giving the Court of Chancery power to convoke a meeting of creditors in order to decide on proposed compromises. A simple majority by numbers and a three-fourths majority by amount of debts was authorised to accept a compromise or arrangement binding on the dissentient creditors, if sanctioned by the Court. By c. 61 of the same year life insurance companies were regulated

[1] *Edinburgh Review*, vol. 127.

by the requirement of a deposit of £20,000, by imposing separate management and accounting where the company carried on other business also, and by insisting on an actuarial examination and report every five years.

SOURCES

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11. French Company Legislation under the Second Empire

THE SOCIÉTÉ ANONYME

As we have seen already (§ 7) one class of companies was subject to very careful scrutiny before it could start activities, whereas *commandites par actions* could do as they chose. In consequence, all dubious promotions took the form of *commandites*. The recurrent crises brought about the collapse of a disproportionately large number of these. The most unscrupulous promotions were based on the issue of shares of very small amount: bogus companies frequently had their capital divided into one-franc shares, by which the poorer and more gullible members of the public were attracted and deprived of their savings.

Reform of company law had long been urged, but it was not until 1856 that the first step was taken by the enactment of an amendment to the law dealing with the *commandites*. The principle of free formation was retained, but the new law introduced certain normative rules both as to the formation and the management of these companies.

In *commandites par actions* with a capital not exceeding 200,000 francs, the shares were to have a par value of at least 100 francs; for a larger capital the minimum par value was to be 500 francs. No issue of shares was allowed until the capital had been fully covered by subscriptions and 25 per cent. of the par value paid in cash. Before full payment no bearer shares were to be issued, and the shares were not negotiable until 40 per cent. had been paid up. In all cases where any part of the capital was to be provided by other contributions than cash—the so-called *apports*—the share-

holders had to verify the *apport* in general meeting and to resolve upon the formation of the *commandite* in a second meeting. In both meetings a majority both in numbers and in holdings of shareholders contributing cash was required. Interested shareholders had no vote. The same rule applied with regard to any advantage reserved for a shareholder.

The law brought a new factor into the structure of *commandites par actions*: the Board of Supervision. Every *commandite par actions* had to have such a board, consisting of at least five members to be elected by the shareholders in general meeting before business began. The election was to be for one year. Subsequently the board could be elected for not more than five years. The board of supervision was to examine the books, cash and securities of the company and report to the shareholders. Without such report no dividends could be paid. The supervisors were authorised to convene the general meeting and to propose the dissolution of the company. In case of failure to perform their duties the supervisors became liable, and certain defaults on their part were penalised.

Should a *commandite par actions* be created in contravention of the law, any interested party might sue for a declaration of nullity. Should it be declared void, the managers (*gérants*), the supervisors, and persons who had contributed assets other than cash would become liable. For gross violations of the law, such as acceptance of simulated subscriptions, the paying of dividends without profits, and so on, severe penalties were enacted. In order to ensure compliance with the law, the *gérants* and the board of supervision were to file a declaration with a notary public certifying that the requirements as to subscription and payment had been carried out. The law also foresaw the possibility of an action by the supervisors or a group of shareholders against the *gérants*, and provided that in such case they must sue through a commissary chosen by them.

The Law of 1856 undoubtedly had the effect of slowing down the formation of *commandites par actions*, and contributed to prevent the issue of bogus shares. It even had to be relaxed somewhat in 1857.

In the case of joint-stock companies proper, the *sociétés anonymes*, on the other hand, it was found that the requirement of administrative assent did not in all cases prevent abuses, and was in itself an obstacle to the formation of new companies.

The position grew somewhat awkward in consequence of the commercial treaty with Great Britain concluded on 15 March 1862, providing that British limited companies formed under the Companies Act of 1862 might establish branches in France without restriction. It was consequently felt that French law must provide a somewhat easier method of forming joint-stock companies, for otherwise all undertakings which could not obtain governmental assent would come into existence as French branches of English companies.

The Imperial Government resolved to introduce a company law amendment allowing of the formation of *sociétés anonymes* with a capital not exceeding 20 million francs without the necessity of Imperial assent. This suggestion, though opposed especially by commercial interests in the large seaports which were still hostile to limited liability, became law on 29 March 1863.

The new law gave these companies a new name: companies with limited liability, *Sociétés à responsabilité limitée.* The original intention was that the law should apply only to companies with a capital not exceeding 10 million francs, but this maximum was increased to 20 millions. Companies with a capital of up to 200,000 francs were to have shares of a minimum par value of 100 francs, those with a larger capital a minimum par value of 500 francs. The minimum number of shareholders for formation was fixed at seven.

The members of the board of directors (*Conseil d'Administration*) were to be elected by the shareholders in general meeting. Their term of office was to be fixed by the articles, but was not to exceed six years. The law provided that the board of directors (*administrateurs*) must deposit with the company at least 5 per cent. of the total share capital in shares issued in the directors' names. The directors were to have equal holdings in these shares, which were declared inalienable during their term of office so as to serve as collateral for the directors' obligations arising out of their legal liability.

The normal quorum at general meetings was fixed at one-fourth of the capital, or at one-half for special questions such as increase or reduction of capital, alteration of articles, etc. To control the management the law provided for the election of commissaries (*commissaires*) with a term of office of one year.

To some extent the law regulated the accounting of these companies. It prescribed that the *administrateurs* must prepare

quarterly statements of assets and liabilities, and a detailed inventory and summary balance sheet at the end of each financial year. This balance sheet was to be presented to the commissaries for examination; they were to prepare a report to the general meeting. Both the balance sheet and the commissaries' report were to be open to inspection by the shareholders at least 15 days previous to the meeting. A legal reserve was to be formed and it was provided that one-twentieth, or 5 per cent., of the profits should be placed to this reserve fund until it amounted to 10 per cent. of the capital.

There is a remarkable protective clause in the law in favour of minorities. Shareholders holding at least 5 per cent. of the capital were empowered to sue the directors on behalf of the company. There was also a provision forbidding directors to acquire any personal interest in transactions of the company.

The articles, i.e. the deed creating the company, were to be filed with the office (*greffe*) of the *juge de paix* and with the *Tribunal de Commerce* and to be open to inspection by the public. Should three-quarters of the capital be lost, the directors had to convene a general meeting to decide upon the question of dissolution.

In other respects the provisions of the law of 1856 were extended to the limited liability companies to be created under the law of 1863. Both laws also contain an interesting clause on the effect of non-compliance with their provisions when companies are being formed. In such a case the company may be declared void by the Courts on action brought by any interested party. Shareholders, however, might not plead this nullity as against third parties in order to evade their liability, i.e. the payment of the par value of their shares. This doctrine of nullity is still a characteristic feature of French company law.

In consequence of these two laws France had now three kinds of companies: the *commandite par actions*, the limited company under the law of 1863, and lastly the joint-stock company (*société anonyme*) under the *Code de Commerce* requiring a charter, i.e. the approval of its formation by the Government. This position was felt to be confusing; especially the provisions of the law of 1856 were felt to be too strict in regard to the *commandites par actions*, whereas the limited company class was not too popular and was restricted to undertakings of medium size. Moved by these considerations, the Imperial Government prepared a codification of company law, which became law in 1867.

This law somewhat relaxed the strict regulations of the law of 1856 in regard to the *commandites par actions*. Nominative shares became negotiable after payment of 25 per cent. The articles could provide that, after payment of 50 per cent., the shares might be transferred and the subscribers freed from further payments. Nominative shares became convertible into bearer shares after such payment, but the obligation of the original subscriber was to remain in force for two years. The board of supervision might consist of not more than three members, whose term of office was to be fixed by the articles; the maximum term of the first board was still one year. Lastly it was provided that each member of the board of supervision should be liable only for his own delicts.

In the case of the *société anonyme*, the requirement of Government authorisation was abolished. Henceforth companies could be formed freely provided they complied with the legal requirements. Thus the French law altered the system of concession by the Government into a normative method of regulation. This regulation itself is in many respects identical with the rules contained in the law of 1863. The requirement of seven shareholders is maintained, as are the provisions as to the size of shares according to the capital of the company, i.e. the minima of 100 and 500 francs for companies with less and more than 200,000 francs capital respectively. The shares might be bearer or nominative shares, and were transferable under the same rules as were provided for the *commandites par actions*.

Two general meetings are to be held when *apports* are to be taken over by the company or special advantages granted to a promoter, shareholders, or any other person.

The first board of directors (*administrateurs*) may be appointed for a term fixed by the articles, but with six years as maximum. In principle the directors should be shareholders, but their qualification was left for the articles to fix. This requirement thereby lost its importance. Commissaries were to be elected yearly. They had the right to enter the premises in the last quarter of every financial year to examine the books, records and transactions of the company. Otherwise the rules remained unchanged.

Beside the inventory and the balance sheet, the law required a profit and loss account to be drawn up. In order to secure careful examination of the balance sheet and accounts, the

administrateurs must present them to the commissaries at least forty days before the meeting.

One general meeting at least was to be held every year. The authority of the general meeting was to be supreme within the company; on the other hand the law gave full power for the articles to fix the quorum and the voting rights apart from the first general meeting, or the two constituent general meetings if these were required in view of the question of *apports* or special advantages.

The constituent act, i.e. the articles, must be filed at the office of the *juge de paix* and the competent Commercial Tribunal. Further, an extract must be published in one of the newspapers authorised to receive official advertisements. The documents filed were open to general inspection, and anyone might demand from the company a copy of the articles for the extremely small fee of one franc. Finally, the documents filed were to be displayed at the premises of the company.

If we examine the law in the light of experience gathered over the eight decades since its adoption it is obvious that the change-over from the system of Governmental authorisation to that of rather meagre regulation was somewhat hasty. It was said in the French *Corps legislatif* that the provisions of the law conferred a regulated freedom, but in fact there was very little regulation left. It is therefore no matter for surprise that after the enactment of the law many complaints were heard. More or less comprehensive drafts of amending laws were repeatedly drawn up. Some of them came before the Legislature, and one draft was even adopted by the Senate, but did not meet with the approval of the *Chambre des Députés*. It was only in 1893 that an amendment was enacted.

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12. Companies and Company Law in Germany and the German Commercial Code

Whereas business associations in Germany were flourishing, strong and active in the later Middle Ages and the Renaissance, the upheavals of the Reformation and the Thirty Years War

impoverished all the States of the Empire to such an extent that there was no basis or prospect for any such bold and lasting enterprise as would have called for the provision of large capital sums by joint effort. After the Thirty Years War the Hapsburg emperors and some of the German princes attempted to form companies for colonial enterprises and overseas trade and to imitate the mercantilist policy of other countries, especially France, but these enterprises were abortive or short-lived, like the Brandenburg-African Company in 1662 or the Oriental Company created by the Emperor in 1719.

Not much was achieved during the 18th century. The German Princes, the King of Prussia especially, were relatively ambitious in pursuing various schemes for establishing new undertakings, but the public showed little response, and there was very little sign of the spirit of adventure met with in England or the Netherlands. The mercantile class especially was strongly prejudiced against corporate enterprise. The Hansa Federation declared in 1627 in an answer to the Emperor that they did not consider the creation of companies a proper method for mercantile undertakings. In their view the individual merchant or at most the partnership were adequate channels for trade. As late as 1720 Hamburg prohibited the establishment of an insurance company on a joint-stock basis. It is not surprising therefore that if and when a joint-stock company was established, the State had to take over a large part of the capital.

In 1765 Frederick the Great established the so-called Königliche Seehandlung, a company originally intended to engage in overseas trade. The State had to take up 97·5 per cent. of its capital. The Company was not successful, and in 1795 had to be transformed into a State bank for the management of its financial affairs, although without the right of note issue.

Thus, until the Revolutionary Wars, there were very few companies in the German States. Those which did exist were created by special charters from the Sovereign. The charter provided for the regulation of the company; there was no company law. Even the Prussian Code of 1794, in spite of its great volume and its attempt at completeness, contained no special provisions for joint-stock companies. Napoleon's *Code de Commerce* as a whole, including its provisions regarding joint-stock companies and *commandites par actions*, was introduced in the States of the Rhine Confederation, and remained in force after 1815,

thus governing company law in the most prosperous and economically advanced part of Germany. This was the case in the Rhine Provinces and Westphalia, which in 1815 became part of Prussia.

Under this régime business corporations began to evolve, especially in Prussia. They were chartered by the King, and the rules governing the company had to be contained in each individual charter. But a fundamental change is to be observed in the policy of the Prussian Government with regard to companies. Whereas in the 18th century the Government had done everything it could to induce merchants and capitalists to unite their means for the formation of companies and bigger undertakings in general, in the 19th century it was obviously prejudiced against companies, and the royal assent was given only with reluctance. The Government was specially opposed to the formation of mining companies, and in order to restrict speculation favoured the formation of *Gewerkschaften*—mining companies of the old-fashioned type. The corporate capacity of these companies was recognised and the members (*Gewerke*) were not liable as against third parties. They could make calls and request additional payments (*Zubusse*) without limit, but the member could abandon his share and thus get rid of the burden of future payments. The position in the shipping companies (*Rhederei*) popular in seaports was similar, with the difference that in cases of bankruptcy and liquidation the members could be sued for a proportionate part of the deficit.

This legal structure was a definite obstacle to the participation of wider circles in such ventures. The members of mining companies were mainly professional mining entrepreneurs, their relatives and close friends. Transfer of shares was exceptional. It was only after joint-stock companies became widespread and their shares were quoted on the Stock Exchanges that shares in mining companies (*Kuxe*) also became objects of trade. In the case of *Rhedereien* investigations show that as a rule it was the master and the mates who took up the shares. Craftsmen and traders whose work concerned the ship and its equipment, or who had contributed material to it, frequently became members also. Participations for investment alone were infrequent and relatively small. At Rostock, in 68 *Rhedereien* formed before 1850, only 12·7 per cent. of the shares were owned by members who had a merely capitalistic interest in the enterprise. As late as 1860 the capitalist interest in 135 *Rhedereien* formed in the decade

1850–60 amounted only to 19·4 per cent., though the boom in shipping between 1853 and 1855 would have justified an expectation of more widespread participation.

This condition of the law and the Government's attitude to granting charters were strongly resented, especially by the mercantile class, and the Prussian Government could not maintain its opposition, particularly in the case of railway undertakings. The general attitude favoured the construction of railways from public funds. But this was not possible in view of the weak state of public finance. Charters were therefore granted to railway companies, and in 1838 a law for their regulation was passed in Prussia. Thenceforward it was no longer necessary to enact special regulations for each company in its charter. Moreover, in 1843 a general Company Law was enacted for Prussia.

This law was based on the whole on the *Code de Commerce*, but it provided only for joint-stock companies proper, the *sociétés anonymes* of French law. The law maintains the concessions system. After the contract constituting the company and containing its articles, called its contract of association or its statute, has been drafted, Government assent is to be obtained. Without this the company cannot come into existence. The royal assent was to be published in the *Bulletin of Statutes*, and an extract from the articles published in the provincial *Gazette*, and in some cases in the *Bulletin of Statutes* also. The Government was empowered to repeal the charter against compensation at any time. Such compensation was to cover only actual damage, and not loss of profits. Forfeiture of the charter without compensation was possible only by judgment of the Court. The shares were to be nominative, but the issue of bearer shares might be approved after full payment. Scrip for interim shares could not be issued to bearer, but the articles might authorise the transfer of shares after 40 per cent. of the par value had been paid up. Bearer shares were to be transferable by delivery, nominative shares by registration of the transfer in the company's books. In the event of transfer before full payment, the original subscriber was to remain liable for the balance. The company could release him from liability, but even then he remained liable for one year in case the company should either be dissolved or become bankrupt within that period.

An interesting feature of the Prussian legislation is that the company was empowered in its articles to lay down penalties

in case a subscriber should not pay the call, and these were not subject to the rules restricting penalties for the non-payment of monetary debts.

The company was regarded as an independent legal entity. Thus earlier disputes regarding the juristic personality of corporations were settled.

The law accepted the principle of limited liability without exception, as did the *Code de Commerce*.

The company must have one or more managers (*Vorstand*). No provision was made for the appointment of a board of supervision, but there was no obstacle to such provision being made in the articles, and as a matter of fact under the law of 1843 many companies chose to adopt such a board in addition to the managers. The law regarded the general meeting as the supreme organ of the company. Voting rights were to be determined by the articles without any compulsory stipulations, and the companies had full autonomy to regulate quorums, requirements as to majorities and so on.

All companies were under strong Governmental control to the extent that, if more than 50 per cent. of the capital were lost, the company had to report to the Government, on whose discretion it depended whether it should be dissolved or permitted to continue its business. The general meeting had the power to resolve upon dissolution, but even then the assent of the Government was required for the resolution to be valid.

Under the law of 1843 concessions for the formation of companies were granted more easily. Whereas earlier the Government had made the grant of a charter dependent upon proof that the formation of the company would promote the common good of the realm, under the instructions of April 1845 this was no longer necessary, and the Government's assent could be given if the purpose of the company could be regarded as useful on general grounds.

Whereas from 1800 to 1825 only 16 companies were formed with a total capital of eleven and a half million thalers, i.e. about £1,600,000, the total share capital of companies in Prussia in 1850 amounted to 160,631,428 thalers and their number to 112. Of these, railway companies formed the largest part. Their capital amounted to 103,073,100 thalers; besides the shares, debentures to the amount of 52,346,300 thalers were issued. Insurance companies followed next both in number and amount

of capital (27,433,111 thalers); banking and credit companies represented a capital of 9,064,000 thalers, mining companies 13,101,000 thalers and industrial companies only 3,933,700 thalers.

Before 1843 Prussia had some unincorporated companies also, though of very small size. They were looked upon as partnerships without corporate status and with unlimited liability. In some cases, however, the Government accorded the privilege of subsidiary liability to the extent that creditors could sue the shareholder-partners only after the common assets of the partnership were exhausted. In other cases unincorporated companies were allowed to acquire real property in their own name without having corporate status, i.e. merely for convenience of management. After the law of 1843 such unincorporated companies were strictly relegated to the role of partnerships.

In Austria the evolution of corporate enterprise was even slower. In 1843 an Imperial Order provided that companies could be created only by charter, and that during the whole of their corporate existence they should be under Government supervision. The Order provided for the holding of a general meeting, the management of the company by managers, and the election of a committee. The same rules were retained by a law governing associations in general, passed in 1852.

Though other German states prepared drafts of company law, none of them was adopted. As we have already stated, in Western Germany the Prussian and Bavarian Rhine Provinces, Hesse and Baden, the French *Code de Commerce* remained in force after 1815 and only in the Prussian Rhine Province was it supplanted by the law of 1843.

There was a strong movement throughout the German Federation for the unification of the law. In the forties a uniform Bill of Exchange law was adopted and in the eighteen-fifties the movement was extended to commercial law, including of course company law. On the basis of several drafts, mainly of one prepared by the Prussian Government, a committee of experts delegated by the member-States of the German Federation after long and careful deliberations at Nuremberg drafted a project for a general German Commercial Code in 1861. This project was subsequently adopted by the member States and promulgated as an independent law for each of the members during the years 1861–3.

The law contained, *inter alia*, a full codification of company legislation, applying to both joint-stock companies proper and *commandites par actions*.

The question whether the system of concession (Government charter to each company) should be retained, or the free formation of companies permitted under the regulations provided by the Code, was left to the discretion of the member-States. Prussia maintained the requirement of individual charters for companies of both classes. Other States, such as Saxony, the Hansa Towns and with some exceptions Baden and Wurtemburg, made the formation of companies generally free. A large number of States adopted the French system, i.e. free formation of *commandites par actions* (*Kommanditaktiengesellschaft*) and concessions for joint-stock companies. For both classes a minimum par value for shares of 200 thalers (£30) was adopted. *Commandites* were not allowed to issue bearer shares.

The partner in a *commandite par actions* had to participate with a contribution which could not be divided into shares and was not transferable. There was no minimum, however, for such contribution. Partners could leave the company only with the assent of the general meeting. The election of a board of supervision (*Aufsichtsrat*) was made compulsory, whereas joint-stock companies could provide for the election of such boards by their articles or not at their own discretion. Only a board of management (*Vorstand*) was necessary. If a board of supervision existed, it had to supervise the management; it had power to inspect the company's books, records and cash. It was the duty of the supervisors to examine the balance sheet and the proposal for dividends. The preparation of the balance sheet and the proposal for dividends in the case of a *commandite par actions* was in the competence of the partners; in the case of *Aktiengesellschaften* in that of the managers. The final decision as to both belonged to the general meeting.

A further characteristic trait of German company law and practice appearing in the Code is that the managers were granted absolute power of representation as against third parties. It was provided that in their relationship with the company managers should observe restrictions contained in the articles and likewise follow instructions given by the general meeting; nevertheless all contracts made by the directors were to be binding as against third parties. The only consequence therefore was that the

managers were liable for damages should they not comply with such restrictions. In other respects the provisions of the Code were similar to those of the Prussian law of 1843 and of the French *Code de Commerce* and the law of 1856, from which the provisions as to the board of supervision were taken.

Before the Code the German practice had been that, beside the managers, who as a rule were not shareholders, or at any rate not holders of large blocks of shares, but salaried executives, the shareholders elected from their own ranks a council or committee to decide on business policy, and to assist and supervise the managers. Such boards were often called Councils of Administration (*Verwaltungsrat*). In instituting the council of supervision the Code had in mind mainly the checking and control of the management; so at least it would appear in the light of the text of its provisions. We shall see that this aim was not achieved.

It is to be noted that the text of the Code begins with regulations for the *commandite par actions*, as if companies of this class were the basis of company law in general. This curious legislative technique was perhaps to some extent justified in France, where the *commandites par actions* had for a long period been very numerous and represented *in toto* a large capital, but hardly so in Germany. Nevertheless it was maintained by the German Reich until 1900. On the other hand the Code regarded the *commandite par actions* as a separate class of partnerships *en commandite*, and although it could make contracts, acquire and hold property of any kind, sue and be sued, its corporate status was not fully recognised.

Company law as it was codified in the Code remained in force in Austria. The North German Federation, from which Austria was excluded, as reconstituted after 1866, enacted in 1870 an amendment to the part of the Code dealing with company law. The first and most important change was that the formation both of partnerships by shares and of companies was declared to be free, so that the concession of a grant by the Government was no longer necessary, except for special franchises if these were required for the company's undertaking. The minimum par value for shares was reduced to 50 thalers, or about £7 10*s*. The provision that *commandites par actions* might not issue bearer shares was maintained, whereas the bearer shares of companies, if issued, were required to have a value of at least 100 thalers (£15). The payment to be made before the registration of the

company was fixed at 10 per cent. Instead of the two meetings previously required in the case of *apports*, one only was provided for.

The position as to the board of supervision was to some extent ambiguous. This institution was extended to the joint-stock company, from which it might have been concluded that it was compulsory. The law, however, was not clear on this matter, and in the next enactment, that of 1884, it was found necessary to include an express provision to this effect.

In order to preserve the integrity of the company's capital, it was provided that until this was fully paid up no dividends were to be paid. A new regulation was the prohibition of acquiring shares in a company out of its own funds.

Finally the law contained certain provisions with regard to the balance sheet, two of which were of great importance: (1) quoted securities could not be accounted at a higher value than their purchase price; (2) the expenses of organisations were to be counted as losses and could not be taken into account as assets of the company.

Thus the victory of *laisser faire* in company matters in Germany became fairly complete.

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13. American Business Corporations to the Civil War

Until the War of Independence the English Crown maintained its prerogative of creating corporations in its American colonies. Some of these colonies, e.g. Virginia and Maryland, were themselves originally corporations created by royal charter. In such colonies the doctrine of the common law prevented any aspiration to create corporations of a local colonial character, since following

Shepheard it was held that a corporation cannot create another corporation. This doctrine was adopted by the Courts in Robinson *v.* Groscot (1696) and Creddon *v.* Eastwick (1704). In the proprietary colonies the royal charters provided that the proprietor might create corporations for the improvement of the colony. In the royal colonies there was no such express rule, but the colonial legislatures vindicated their right to grant charters to local corporations. Finally corporations were chartered by the Crown itself, some with seats in England, others with seats in one of the colonies.

The chartered colonies had not much success in the form of chartered companies, and after a more or less short corporate existence the charters were surrendered.

From the beginning of the 18th century nearly all the colonies tended to assume the right to grant charters independently of the royal prerogative. In several cases the Crown gave its assent to such charters. In other cases royal charters were not granted, and it was doubtful whether such corporations had a legal existence or not.

In consequence of the state of colonial economy there were very few business corporations which were colonial both in origin and in their area of activity. There were unincorporated companies in existence, and the Bubble Act, as already mentioned, was extended to the American Colonies in 1741 by 14 Geo. II, c. 37; but we know of no case in which it was applied.

We know of wharf and pier companies in existence at the close of the colonial period, e.g. those of Newhaven (1760) and Boston (1772). In Philadelphia there was an insurance company against fire formed in 1752 and incorporated in 1768. This company was in fact, however, a mutual assurance company.

A water company had already been formed in Boston in 1652, but without a common name, while in 1772 and 1773 three water companies were formed in Rhode Island. The New London Society for Trade and Commerce in Connecticut was formed in 1732, but could not obtain a charter. Two other projects for trading companies with the right to issue notes were brought forward in 1740, but nothing came of them. There were certainly unincorporated companies for trade, fishing, whaling and drainage, as well as some mining and a small number of manufacturing companies, but without corporate charters.

On the whole the use of the corporate device was rare, and

corporations were not at all popular, partly because of the undecided question of the right to grant charters and partly because they were identified with monopolies. It is to be remembered that the very fact which brought the antagonism of the thirteen Colonies towards the Motherland to a head was the oppressive policy of the East India Company.

The War of Independence fundamentally altered this situation. The rights of the Crown fell into abeyance, and the colonies as sovereign States asserted their right to grant charters. There was some dispute between the Executives and the Legislatures of the States. In the end the Legislatures prevailed. The constitutions of Pennsylvania and Vermont expressly provided for the creation of corporations; in other States this power was regarded as implied.

The question of the power of Congress to incorporate was raised at an early stage, and although it was disputed Congress as early as 1781 passed a resolution to charter a commercial bank, the Bank of North America. This bank felt the need to obtain separate charters from several States as an additional protection. The question was again raised on the creation of the first Bank of the United States, and on the formation of the second Bank in 1816. It was eventually settled by the Supreme Court in McCulloch *v.* Maryland [1] in 1819. Thereafter it was a universally accepted rule that Congress had the power to grant corporate charters if they were instruments of federal policy, e.g. to regulate the question of currency.

The reason for the unpopularity of corporations disappeared with the assumption by the Federal and State Legislatures of the power to grant charters; nevertheless hostile feeling and prejudice remained. But economic conditions called for the formation of larger undertakings, and after the close of hostilities it was possible to get together substantial capital sums. From 1783 to 1800 more than 300 business companies were incorporated —90 per cent. of them after 1789.

The incorporation was generally effected by special Acts, either granting the charter or authorising the Governor of the State to issue it. Some foundations were even laid for a general corporation law. Thus in 1795 North Carolina adopted an Act providing that canal companies might be freely formed, although they obtained only the right to sue and be sued without full

[1] 4 Wheat. (U.S.), 316.

corporate character. An Act of Massachusetts of 1799 provided that any number of persons could freely form a corporation for aqueducts, companies so formed having corporate character, and the stockholders being liable only in case of dissolution. This Act was extended in 1811 to all corporations whatever their purpose.

The corporations created between 1783 and 1800 were substantial not only in numbers but also in size. The Bank of North America had a capital of about 800,000 dollars, the first Bank of the United States one of $10,000,000. It is significant that Congress contributed $2,000,000 from Federal resources to this first Central Bank of the U.S.A., and States took part with substantial amounts in banks of a local character.

Of the 300 corporations formed in this period about 60 per cent. were highway companies, about 20 per cent. had banking or insurance as their object, about 10 per cent. were local public service companies, and only about 4 per cent. were concerned with other business purposes. There were joint-stock banks in New York, Boston, Maryland and other places. Canals were also a frequent object of company operation. These early American canal companies, unlike the English ones, yielded very small profits, and there was urgent need for the participation of public bodies in such enterprises. Before 1800 there were in existence altogether 74 companies for the improvement of inland navigation. Bridges and highways too, which in England and other countries were constructed by public bodies or non-profit-making trusts and corporations, came in the U.S.A. within the sphere of commercial companies. A large number of companies—73 before 1800—were chartered for the erection of bridges, with the right to levy tolls for their use. Most were of moderate size, as the construction presented no difficulty, and they could be content with moderate tolls. The bridging of larger rivers presented much more difficult problems; the expenses were naturally higher and could not be calculated in advance with any exactness. Even with higher tolls the enterprise could not yield satisfactory profits. From 1792 onwards highways began to be constructed by turnpike companies. Most of these were for short routes, and the companies were therefore small entities. There was much opposition to them, and their relatively small number in this period (72) shows that their day was still to come.

In the field of assurance both mutual and joint-stock companies existed. Most of them were engaged in maritime assur-

ance. Fire insurance companies were mostly mutual institutions. The beginnings of life assurance can also be seen. The total number of assurance companies was 31; the size of the joint-stock companies in this field was moderate, only a few of them having a capital larger than $500,000.

The small number of water supply companies, 32 in all, shows that at this period Americans were not as yet sufficiently interested in a pure water supply. One such company, the Manhattan Company, with an authorised capital of two million dollars, used its funds mainly to carry on a banking business.

Only eight manufacturing companies were chartered, mostly for textiles, and in the long run none of these was successful. This was due mainly to general economic conditions, which were not favourable to the evolution of industry. Records show that a certain number of unincorporated joint-stock companies were engaged in manufacture.

It says much for the soundness of corporate economy that according to the historian of business corporations in this period, J. S. Davis, there was no serious loss to creditors even in cases where the shareholders lost most of their capital.

We know from the records of several companies that the shareholders came mostly from the merchant class, but small savers also took part. These naturally mostly took shares of small denomination. The par value of turnpike shares was generally between 20 and 50 dollars. Bank and canal company shares were mostly issued at $250–500; at the end of the period $100 shares appear.

Davis indicates the distribution of original subscriptions in the case of eight companies; only one of these had more than 500 subscribers. In the Bank of North America five subscribers took nearly 50 per cent. of the shares, and with an additional sixth shareholder they controlled the Bank by an absolute majority. It is probable that actually holdings were even less widespread, since in most cases subscriptions were limited to a moderate maximum, and therefore capitalists made use of dummies.

Moved by anti-corporation prejudice, many charters sought to provide guarantees against individual domination of the companies by prescribing limits to subscriptions and a regressive system of voting. Possibly the time limits of franchises and the provisions for reversion of public service enterprises were also due to pressure of public opinion.

In many cases the charter reserved the right of alteration and repeal.

The question of repeal had been raised in the Assembly of Pennsylvania in 1785. The charter of the Bank of North America granted by Pennsylvania had been repealed by that State in that year. As we have said above the Bank also had a charter granted by Congress. It did not take action before the Court, but the legality of the repeal was raised in the State Assembly. One representative, a prominent lawyer, put forward the doctrine which subsequently became so famous in the Dartmouth case, that a charter is a "compact" between the State and the corporation. The question was not in that instance settled, and the Bank satisfied itself with a new charter. Subsequently State authorities became more cautious, and repeals and alterations were effected only in cases where public opinion strongly favoured them.

Despite all prejudice, it can be asserted that charters were much more easy to obtain in the U.S.A. after 1789 than either before or at the same period in Great Britain, nor was procedure so expensive. In the nineties the prejudice and hostility were decreasing, and as we have seen substantial progress had been made: the number of chartered companies appears very large in comparison with the number chartered during the same decade in England.

In the absence of a general corporation law, regulation was provided by the English Common Law adopted by the State and by provisions contained in the charters. These, however, differed widely in their contents. Some provided fairly complete regulation, others gave practically no details. This was due, according to Davis, to the fact that the Assemblies accepted the drafts presented by the petitioners. Even in this period endeavours towards a general corporation law were being made.

Limited liability was generally granted, either expressly or by implication; in one case only is its refusal recorded.

Most of the companies were formed for a single purpose and, contrary to the English axiom regarding chartered companies, it was held in America from the beginning that corporations have only the powers granted by their charters, and that every act not authorised thereby is *ultra vires*. In some cases, however, the charter gave a company the right to extend its activities. Thus the Manhattan Company's charter authorised it to apply its surplus to any purpose not prohibited by law.

Practically no monopolies were granted to American companies in this period. The only material exception was that of the Bank of the United States of America, which for 20 years had a charter excluding the chartering of any similar bank. Bridge companies generally enjoyed protection by a prohibition of the building of other bridges within a certain distance.

The Common Law rule that corporations cannot create other corporations was accepted by the Courts, but in fact insurance companies held shares in banks and other companies.

At this period profits were generally divided in full and no attempt was made to form reserves. This was most conspicuous and harmful in the case of insurance companies.

The English doctrine that companies are entitled to regulate their internal lives by by-laws was recognised, and these were held binding unless contrary to law or the charter.

Another characteristic innovation as contrasted with England was that many charters were granted only for fixed and generally short terms, e.g. ten years.

There were even in these early times substantial differences between State and State in the evolution of companies and the Governmental attitude to them. After the Bank of North America had been incorporated in 1782 the Massachusetts Bank was created in 1784 and two other banks in 1792 and 1795. The Massachusetts Fire Insurance Company was incorporated in 1795. The first charter for a manufacturing company, the Beverly Cotton Manufacture, was issued in 1789 and a second in 1794 for the Newbury Port Woollen Manufacturing. The State legislature insisted in most cases on unlimited liability, at least for judgment debts unsatisfied by the corporation, though not with banks and insurance companies. But manufacturing companies were not limited as to the terms of their charters, whilst bank and insurance charters were granted only for terms not exceeding twenty years.

In New Jersey the State legislature seems already at that time to have been favourable to companies. This has been generally attributed to Alexander Hamilton's influence, though it may have been connected with the State's geographical position. The charter granted in 1791 to the Society of Useful Manufactures (Associates of New Jersey Company) was exceptionally magnanimous, including a gift of 36 square miles of land, with wide powers. To the capital of $1,000,000 the State contributed a

hundred thousand dollars, and the Company was granted exemption from taxes for ten years.

The New York legislature likewise favoured corporations, largely because of the State's commercial position. The same may be said of Pennsylvania. In Maryland, on the other hand, evolution was slower and the earliest incorporations were those of banks and insurance companies. One Baltimore bank, however, had already a capital of three million dollars.

After 1800 corporations increased, and from about 1810 onwards many manufacturing companies sought and obtained incorporation. The beginning of the railway age is a landmark in the evolution of corporate enterprise. Railways in the U.S.A. were built by private corporations. Georgia alone provided from public funds for the construction of the railroad from Charleston to Chattanooga.

This period is noteworthy in the common law field for the judgment of the Supreme Court in the Dartmouth case and the first enactment of a general corporation law. It has been justly pointed out that the U.S. Courts had very little help in this matter from English Courts and literature. As we have seen (§ 6) Courts in Great Britain seldom dealt with business corporation cases, and legal literature was mainly concerned with public or non-profit-making corporations. Business men and lawyers probably knew something of English business practice and decisions, but on the whole corporation law had to be built up on independent lines.

As we have said above, a charter was regarded at first as a kind of contract between the Sovereign and the corporation, binding on both, and not to be terminated without mutual assent save in case of abuse. After the Revolution the question became governed by the Constitution of the United States Art. 1, § 10, which prohibits the State from impairing the obligation of contract. This was decided in the famous case of the Trustees of Dartmouth College *v.* Woodward [1] which related to an educational corporation created from private means by Crown charter granted in 1769. The State legislature of New Hampshire in 1816 passed Acts to end a deadlock in the administration by increasing the number of trustees by nine, vesting in the State Governor the right to appoint the additional members, and creating a board of overseers. In an action by the trustees under

[1] 4 Wheat. 518 (1819).

the charter the Supreme Court declared the Acts void. The opinion of Chief Justice Marshall stated that the charter was plainly a contract to which the donors, the trustees and the Crown were the original parties, and that the obligations arising therefrom could not be impaired without violating the Constitution. The Court found that every alteration in the charter, however unimportant, and even though manifestly in the interest of the party objecting to it, impairs its obligation (*per* Washington, J.). This principle was subsequently applied to business corporations and adhered to permanently.

The Dartmouth case was memorable also from another point of view. Story, J., expressed the view that if the State does reserve in the charter the right to repeal or amend it, that right is part of the contract and governs the legal relation between the State and the corporation. This principle likewise became a constant rule of American corporation law, and most charters granted after 1819 included it.

The feeling towards corporations long remained fairly hostile. Senator MacDuffee of South Carolina said in 1828 that corporations are "united and stimulated by the hope of gain, are destitute of individual responsibility and have no feeling for the wrongs and sufferings inflicted upon others". As late as 1837 it was proposed in Pennsylvania that no charter should be granted for projects which individual activity could accomplish, and in Ohio there was a movement in 1851 to substitute partnerships for corporations, though at that time general corporation laws already existed. Simultaneously there was hostility in certain States to the principle of limited liability. Massachusetts restricted it in 1822; Maine altered its rules five times between 1821 and 1856.

State legislations gradually proceeded from the system of granting charters for individual companies to that of a general corporation law. In some States the first step was the enacting of some general rules for chartered corporations while maintaining the necessity of special charters by legislative Act in each case. At a later stage legislatures dispensed with this requirement, and only the filing of the documents with the public authorities was demanded. In this way general corporation laws came into being. In most States this system was at first introduced only for certain classes of corporations, and only later became general. The transition was due partly to convenience: the obtaining of

legislative charters became difficult and caused much delay. On the other hand the whole system became odious in consequence of lobbying and bribery. Useful projects could not obtain incorporation if the promoters were unable or unwilling to secure the goodwill of the majority, while unsound schemes received charters by misuse of legislative powers.

The introduction of general corporation laws was as a rule accompanied by an amendment of the State Constitution or by the insertion of a provision in the general Corporation Act that no special legislative charter should be granted. Some legislatures, however, qualified this rule by retaining the power to enact special charters if in their opinion the purpose of the project could only be secured by special Act.

As already mentioned, most of the States under the influence of the Dartmouth decision reserved in the charters the power to amend and to repeal. The general corporation laws accordingly as a rule provided that all charters to be obtained under the Act by filing the incorporation papers were subject to this power. New York passed an Act in 1811 permitting the formation of companies for certain manufacturing purposes without special legislative charters. This was extended and amended in 1825 and again in 1828–30. But these Acts did not prevent the creation of corporations by special Act, and it was only under the New York State Constitution of 1846 that this practice was restricted to cases where the object of the corporation could not be achieved under the general law. Under the Constitution of 1846 a series of laws was passed for various classes of corporations. Manufacturing, mining, mechanical and chemical companies alone were regulated by a comprehensive Act; railroads, turnpikes, bridges, telegraph, insurance and banking companies were each dealt with by a special enactment.

A similar position arose in Massachusetts, where an Act had been passed in 1809 for the regulation of manufacturing corporations without ceasing to require special incorporating legislative grants: here too separate laws were passed for various classes of corporations, and only in 1851 was a really general statute for manufacturing corporations adopted. Connecticut in 1836 permitted the incorporation of certain classes of manufacturing corporations by filing documents with the Secretary of State.

In New Jersey, where the practice of incorporation by special Acts was fairly liberal, to such an extent that of 282 railroad

charters granted between 1830 and 1871 only 55 materialised, the step of fixing general regulative framework while maintaining the requirement of special legislative incorporation was taken only in 1846. In 1849, however, it was enacted that manufacturing, mechanical, mining and agricultural corporations could be incorporated by declaration filed by four incorporators with the Secretary of State. Other classes of corporations had to be formed by special Acts, and it remained possible to apply for a special charter, especially if some privilege or favour was solicited. Actually the number of special incorporating enactments remained large.

In Maryland the first step, regulation of manufacturing and mining companies plus special legislative charters, was taken in 1839. In 1851 freedom of incorporation was proclaimed in the Constitution, and in the following years several general corporation Acts were passed for mining, manufacturing and other corporations.

Louisiana in 1845 adopted a constitutional amendment allowing of free incorporation, but in Pennsylvania the Act of 1836 provided only for incorporation of iron-manufacturing companies, and in 1849 a general incorporation law was passed only in respect of certain limited classes of manufacture.

In New York the Act of 1811 contained a time limit of 20 years; but in the case of banking corporations extremely long terms were provided for in the charters. The Central Bank of New York was created with a term of 4050 years, and several banking corporations had terms of 500, or even 1000 years.

The size of companies was generally limited. The New York Act of 1811 provided for a maximum of $100,000; the Connecticut Act a minimum of $2000 and a maximum of $200,000. New Jersey had a minimum but no maximum.

Some Acts restricted borrowing powers. New Jersey, in other respects so liberal, provided in 1829 that banking corporations might not contract debts exceeding double the amount of their capital.

Although in some States limited liability was held to be an incident of corporate status, and for example in Connecticut it was held in Javett *v.* Thomas Bank [1] that shareholders are in general not liable for the debts of corporations, statutes did not favour limited liability. Massachusetts adopted unlimited

[1] 16 Conn. 511.

liability for banking corporations, though it was asserted that this would lead to the flight of corporate enterprise from the State. New Hampshire did the same in 1842. In Maryland the charters mostly exempted shareholders from liability in excess of the par value of their shares, but in 1852 double liability was adopted for shareholders of banking corporations. The vote was in most cases limited, and in view of this it became usual to split holdings and to make use of nominees. In Maryland it was found necessary to require shareholders to swear that the shares registered in their names were their own property (1837).

The power of directors to manage the company's affairs was recognised on a fairly wide basis. Many charters even gave them the power to make by-laws.

The beginnings of modern practice are also to be observed in respect of the requirement to carry on business within the State. New Jersey required a majority of the directors to be residents of the State and the head office of the corporation to be situated within it, but in Maryland it was held possible to do business exclusively outside the State, and actually a number of companies sought incorporation in Maryland probably because of its leniency in granting charters, though business was carried on outside the State.

Most of the new incorporations were railways. Industry was the last field to be conquered by corporate enterprise, the industrial sector being dominated by individuals and partnerships. As late as 1850 there existed a partnership with a capital of one million dollars, employing 508 families. Nevertheless from 1830 on, the number of industrial companies was on the increase.

Between 1830 and 1840 capitalists began to acquire interests in various fields of enterprise by purchasing shares. Boston merchants thus became interested in manufacturing and Philadelphia shippers in local factories. The so-called Boston Associates, a group of fifteen Boston families whose first corporate enterprise was the Boston Manufacturing Company (1813), entered the insurance field through the creation of the Massachusetts Hospital Life Insurance Company (1818); subsequently they became interested in waterworks, canals and railroads. By 1850 they controlled 20 per cent. of the cotton spindleage of the whole U.S.A., 30 per cent. of the railroads of Massachusetts, 39 per cent. of the insurance capital and 40 per cent. of the Boston banking resources. Owing to their activities insignificant villages

were transformed into company towns and even into great manufacturing centres like Lowell. They operated in speculative purchases of Western land, and through the insurance companies controlled by them invested in railroad bonds even outside the State.

The size of industrial corporations was still moderate. Railroads, however, required considerable capital. The original investment in the Baltimore and Ohio amounted to $15 millions, in the Erie to 25 and in the New York Central to $30 millions. There was already wide dispersal of ownership and considerable speculative trading in corporate securities. Already in 1838 the Western Railroad of Massachusetts had 2331 stockholders; the New York Central 2445 in 1853, while the Pennsylvania at its creation had over 2600.

Many stockholders could not attend the meetings in person, and proxies came into use. This gave the board an extremely strong position. At the meeting of the Erie in 1854 the board through proxies had 35,000 votes, the other stockholders only 9000. It was not the small stockholder but Vanderbilt by whom the notorious Drew was ousted.

According to Stevens no individual or combination of individuals had an overruling monetary influence, and the basis of control was the character and standing of the persons in control and confidence in their ability, judgment and integrity. But this is rendered questionable by the abuses which became so conspicuous during the following decades, such as domination of a group of companies through interlocking directorates, watering of stock by way of construction contracts, and so on.

With the growth of corporate securities private bankers gained power and organised the flow of capital into stock and bonds. Beside the managers and directors who endeavoured to build the best railroads and to organise industrial production in the most effective manner, a new type of director begins to evolve, whose main ambition was to accumulate private wealth by the use and abuse of the mechanism of the corporate device.

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14. Companies and Company Legislation in Great Britain from 1877 to the Companies Act of 1908

The Act of 1877, 40 & 41 Vic., c. 76, related merely to reductions of capital. There were doubts whether under the 1867 Act the capital of a company might be reduced if it had been paid up. The new Act provided that any company may reduce its capital in so far as in consequence of losses or otherwise there is a discrepancy between the nominal capital and the value of the assets, or by making partial repayments of amounts paid up, or by reducing the shareholders' liability. In each case the reduction is to be effected by special resolution, subject to the Court's approval. Creditors may not object if there is no repayment to shareholders or reduction of their liability; but the Court may direct otherwise. The Court is also given power to dispense with the affix "and reduced" required by the 1867 Act. It may, on the other hand, demand the reason for the reduction of capital to be communicated and may direct how that is to be done. Lastly the Act provided that the capital may be reduced by cancelling unissued shares if such a course is authorised by the memorandum and articles, or by special resolution.

The reform was followed by a crisis, which was most severe in the case of banks, of which many failed. The most damaging insolvency was that of the City of Glasgow Bank, where £12,500,000 was involved, the shareholders having to pay £2750 for a share of £100.

Public opinion called for a reform of company law that would make such scandals impossible. Under the influence of these requests, in 1879 the Act 42 & 43 Vic., c. 76, was passed. Its wording applies not only to banks, but also to any joint-stock company.

In practice, however, other companies did not avail themselves of those of its provisions which they might have accepted, while the provisions as to auditing were restricted to banks alone.

The Act gave unlimited companies power to limit their shareholders' liability. They might also then increase the nominal amount, i.e. the par value, of their shares, so as to provide for a reserve liability in case of liquidation. The amount of such increase could not be called up by the company except in the event of winding up, and then only to satisfy creditors and to meet the expenses of the liquidation. The same could be done in respect of any part of the capital which had not been called up.

The limitation of liability permitted by the Act was made inoperative in respect of existing debts, and the rule that banks cannot limit their liabilities arising from note issue was maintained.

The Act introduced compulsory audits for banking companies, which must elect yearly one or more auditors in general meeting and fix their fees, no director or other officer being eligible. Auditors may be re-elected. They may examine the books and accounts of the company; they are to be given a list of the books. In the case of branches operating outside Europe the submission of copies of and extracts from the books suffices. The auditors are to report to the company whether the balance sheet is full and fair, and gives a correct view of the company's affairs. The balance sheet is to be signed by the auditor, the secretary or manager and at least three directors.

By this Act the compulsory audit provided for in 1844, but abolished in 1855, was re-introduced into English law, though unfortunately only for banks. This does not mean that audits had been neglected since 1855. Respectable companies audited their balance sheet and accounts, and it became increasingly common to employ professional accountants for this purpose. Yet there was no compulsion to audit, and the omission sometimes had grave consequences. Thus in the City of Glasgow case it appeared that the Bank had granted credits amounting to about £6,000,000 to a small number of firms, disregarding the principle of distributing risks. Auditors of any standing would hardly have acquiesced without objection in such a credit policy, quite apart from the question whether the debtors concerned were creditworthy or not; in actual fact they were insolvent.

In 1880, by 43 Vic., c. 19, it was made possible for a company to repay, by special resolution, part of its net assets deriving from

undivided profits, with the effect of increasing the liability of the shareholders by the amount repaid. In such a case shareholders might require the company to retain the amounts in question and re-invest them in trustee securities. It was thought that amounts so retained at the request of shareholders might be applied to satisfy future calls on their shares and that they should receive meanwhile the income from the securities. Such requests for retention were not practical. On the other hand, although the legislation of 1879 was at first not received with enthusiasm, especially by the big joint-stock banks, it soon became obvious that limited liability is not only a guarantee for the shareholders against heavy losses but also tends to increase public confidence. By the end of 1883 not more than nine banks maintained unlimited liability. Not all the banks availed themselves of the reserve liability, though nearly all of them operated with partly paid up shares. Many retained profits or made the unpaid part callable at any time, while some operated with fully paid shares and created reserves. After the eighteen-eighties unlimited liability for banks became quite exceptional, and thenceforth no banking company of any substantial size fell into serious difficulties. Lastly the Act empowered the Registrar of Companies to strike off the register companies which did not carry on business for at least one year.

The decade 1881–90 was one of growth for companies both in numbers and assets. Its last years showed great promotional activity. New registrations amounted in 1888 to £353 millions, in 1889 to £241 millions, and in 1890 to £238 millions. There were, however, signs of reckless promotions, and some schemes were launched which may be rightly described as bubbles. Thus in 1882 a company was formed to carry on business of any kind with a nominal capital of £12 millions, in which only 20 shares were issued. Another with similarly extensive aims had a nominal capital of £10 millions, and lastly a company was created with a nominal capital of £10 millions for railway construction. But only in 1890 was legislation introduced to extend liability for untrue statements in prospectuses. By 53 & 54 Vic., c. 64, directors and others who take part in the issue of prospectuses and notices inviting persons to take shares or debentures were made liable to compensate persons who subscribe or purchase such shares or debentures on the faith of false statements. Liability is excluded if the person concerned had reasonable

ground to believe the statement true, or, when the statement relates to the opinion of an expert, provided that it fairly represents the expert opinion in question, and the signatory had reasonable ground to believe him to be a competent person. The same is to apply to a statement based on an official document, if the document is fairly represented. The Act's intention was sound; but events showed that the protection it gave was insufficient.

In the same year it was made possible to alter the objects clause of the memorandum of association by special resolution confirmed by the Court. Until 53 & 54 Vic., c. 62, it had been held that without liquidation and reconstruction such a change was impossible. The Court received wide powers regarding its approval, and could direct whether creditors who object to the alteration are to be satisfied or secured. It might approve the alteration if it aims at carrying on the business of the company more economically or efficiently, or at the attainment of its main purposes by new or improved means, at introducing new lines of business to the company's advantage, or to a restriction of the company's purposes or to the abandonment of one or more lines of business.

To protect a dissenting minority, the Court was empowered to adjourn the proceedings in order that such shareholders might be bought out by the majority, and to give adequate directions.

These provisions have remained thenceforth a part of the British law.

The decade after 1890 began with a depression, which reached its nadir in 1893. With the improvement of economic conditions, and especially the development of South African mining, a new wave set in, as is shown by the following list of new registrations.

Year	*Number of Companies*	*Nominal Capital (£)*
1891	2686	134,261,673
1892	2607	103,403,331
1893	2617	96,054,161
1894	2970	118,431,570
1895	3892	231,308,077

An amendment in the legislative field in 1898 (61 & 62 Vic., c. 26) provided that where a company entered into contracts to issue shares for a consideration other than cash and the contracts were not filed, the Court may on petition of the company or any

other interested person order subsequent filing, if the omission was due to inadvertence or the subsequent filing is otherwise just and equitable. The Court may even order the submission of a memorandum in writing instead of the contract, if the filing of the latter would be impracticable or cause delay or inconvenience.

Meanwhile a committee was entrusted with the preparation of an amendment of company law necessitated by the experiences of the boom and the subsequent crisis of 1893. The main complaints voiced were against reckless promotions. One interesting case recorded from the early nineties is that of the Ancient Goldfields of Africa. This company was registered with a capital of £10,000 divided into 9,600,000 shares of one farthing, of which only a small fraction was ever issued. Nevertheless even to-day neither a minimum amount of nominal or paid-up capital, nor a minimum par value per share, is required by English law.

The committee, with Lord Davey as chairman, presented its report in 1894, but only in 1900 was an amending Act passed (63 & 64 Vic., c. 48). Its main provisions relate to the creation of companies and the re-introduction of compulsory auditing. The certificate of incorporation was to be conclusive evidence that all legal requirements have been complied with and that the company is authorised to be and in fact is registered as a company. The Act's intention was to end any doubt as to the validity of a company's registration by the Registrar; but as we shall show, the certificate of incorporation was not in itself regarded as sufficient for commencing business.

It was further provided that the directors must declare their consent to act, and this declaration is to be filed with the Registrar. If under the company's regulations (memorandum and articles) directors have to qualify by shareholding, it must be stated that they have complied with this requirement. The Act, however, does not require any qualifying shareholding if none is called for by the articles. If, and so long as, the minimum amount under the articles has not been subscribed and the instalment required, which may not be less than 5 per cent. of the par value, is not paid, the directors may not allot the shares, and they must repay the moneys received from subscribers if these conditions are not complied with at the end of 40 days after the first issue of the prospectus. They must make a return of the allotment of the shares within one month. Commissions for procuring subscriptions may be paid only up to the amount allowed in the articles,

and this is to be disclosed in the prospectus. On the submission of the return of the allotment and a statutory declaration by the directors that this has been made, the Registrar issues a certificate stating, on the basis of the statutory declaration, that the required minimum of subscriptions and payments has been effected. Without such certificate the company may not commence business.

The Act laid down more details as to the contents of the prospectus, and made the directors liable for omissions, unless they could prove that they were not cognisant of the undisclosed facts, or that the non-compliance was due to an honest mistake of fact. Clauses waiving disclosures, which had become usual, were prohibited and declared void.

The directors must convoke a statutory meeting to consider the reports as to the allotment and payment of the shares.

From the standpoint of company management it is important that under the Act shareholders representing at least 10 per cent. of the share capital became entitled to call for an extraordinary meeting, on stating its object to the directors. If such a meeting was not convened within 21 days, the shareholders might convene it themselves.

Mortgages and other charges were to be valid only if filed with the Registrar. This was the first mention of floating charges in a Companies Act.

In the annual summary to be submitted to the Registrar shares issued for cash are to be distinguished from those issued for other considerations; moreover, the amount of debts secured by mortgages or other charges is to be stated. Lastly the names of the directors are to be given.

As we have seen above, audits were introduced for banking companies in 1879. The Act now re-introduced compulsory audit for all registered companies. The first auditor or auditors, as provided by the articles, may be appointed by the directors, and the appointment is valid until the first annual general meeting, but they may be removed by the general meeting even before that. The directors may likewise fill vacancies. Otherwise the auditor or auditors are to be appointed by the general meeting. Their remuneration is to be fixed by the general meeting, or by the directors, as the case may be. They are given access to the books, accounts and vouchers. They are to state whether in their opinion the balance sheet is properly drawn up, so as to

exhibit a true and correct view of the company's affairs as shown by the books, and the report is to be read in general meeting.

The Act did little more as to audits than restore the provisions of the Act of 1844, repealed in 1856. Its provisions as to the certificate of incorporation and that required for commencing business are similar to those of the Act of 1844 as to provisional and complete registration. If we bear in mind that the Act of 1844 was blamed in the fifties on both counts, the reinstatement of these two institutions after more than 40 years of trial and error is an interesting event in company legislation.

It is remarkable that the Act did not introduce compulsory rules as to the balance sheet. In the eighteen-fifties one of the main objections to compulsory auditing, as provided for by the Act of 1844, was that the Act did not contain provisions as to the form and contents of the balance sheet, and therefore auditors had no directions to govern their work. This was one of the reasons put forward for the abolition of compulsory auditing. The institution was now re-established, but without providing for any substantial regulation. There was for a long time much controversy as to how far legislation should go in this matter.

Beside minor amendments as to winding up, and giving power to strike off defunct companies, the Act provided that the inclusion in any return, report, certificate, balance sheet or other document of statements known to be false should be deemed a misdemeanour. A last provision makes it clear that companies may provide for the re-conversion of stock into fully paid shares.

Though in no way revolutionary, the Act of 1900 was to a certain extent beneficial.

The period from 1900 until 1908, when the next important company law reform came into force, was marked by the further evolution of corporate enterprise. New registrations were as follows:

Year	*Number of New Companies*	*Nominal Capital (£)*
1900	4509	206,828,491
1901	3132	206,828,941
1902	3596	147,563,148
1903	3692	115,657,364
1904	3478	83,914,688
1905	3967	108,655,043
1906	4395	125,169,970
1907	4870	125,180,782
1908	4639	96,911,964

It is worthy of note that the average size of companies was constantly diminishing; in 1900 it was £50,700, in 1908 only £20,891. This was due to the extension of corporate enterprise into new channels, mainly trade. In 1877 the then Master of the Rolls, Sir George Jessel, stated that there were hardly any companies engaged in retail trade; after 1900 there was an increasing number both in retail and wholesale commerce. The conversion of existing firms into companies also became more frequent.

Most of the newly registered companies did not appeal to the public, at least in their initial stage. In many cases the former owners of an enterprise took up the whole capital and did not appeal to investors in the first years after the conversion or even at all. The name "private companies" came into use for this class. Thus in 1906 of 4395 new registrations only 424 companies issued a prospectus, and of these only 352 started business.

There were, however, cases in which the issue of prospectuses was evaded by postponing the public invitation to subscribe for the shares and placing them through bankers or finance companies, in which case the issue and filing of a prospectus was not necessary. Larger companies refrained from such a course, and the amount of capital obtained from the public through the issue of prospectuses was increasing. According to one compilation the percentage of the capital of companies which had issued prospectuses increased from 15·25 per cent. in 1904 to 19·03 per cent. in 1905 and 30·66 per cent. in 1906. With the increasing number of smaller companies registered the percentage of short-lived promotions was also growing. Thus in 1908, 2117 companies went into liquidation and 1284 were struck off the register, so that the net increase was only 1238.

In 1907 the Legislature intervened in two directions. Firstly, the institution of limited partnerships was regulated by 7 Edw. VII, c. 24. It must be remembered that it was widely assumed that capital sought placement in companies partly because partnership law was not sufficiently developed and especially because it was impossible to register partnerships in which one or more partners limited their liability to a specific amount. This was permitted by the Act of 1907. The event, however, showed that there was no large demand for this form of enterprise: in 1908 only 133 limited partnerships with a total capital of £264,358 were registered. This lack of popularity has continued until

to-day and the further fate of corporate enterprise was in no way affected by limited partnerships.

A more important event of the year was the passing of the Company Law Amendment Act (7 Edw. VII, c. 50). This inaugurated a number of more or less important amendments of company law in general, and also regulated private companies as a new type of corporation.

In the first-mentioned field the Act aimed at ending abuses in the evasion of the issue of prospectuses by providing that, where no prospectus is issued, the company must file a statement in lieu thereof before beginning to allot shares, and must invite the public to take part in the issue. This statement is to contain the same data as a prospectus.

There was a demand that discounts at the issue of shares should be legalised. The Act allowed them only for debentures. For ordinary shares any discount remained inadmissible, and the rule requiring disclosure of the amount of commission granted for placing shares is repeated.

Companies concerned with public utilities, such as railways, had always been used to pay interest to shareholders during the time of construction. There was a demand for this to be made possible in the case of other companies also. The Act allowed it in so far as companies had issued shares for the construction of plant or works. Payment of interest might then be authorised for a period not exceeding six months following the half year in which the construction or building was finished: it must not exceed 4 per cent. per annum or a lower rate to be fixed by Order in Council. The authorisation was to be either by the original articles or by special resolution and required the sanction of the Board of Trade.

The rules regarding mortgages and other charges were supplemented and made more precise. The doubt whether companies could issue perpetual debentures was solved in the affirmative, and the right to inspect the debenture register granted to any debenture holder.

The position of auditors was strengthened by giving them power to require information from the directors, and their report is to state whether they have received the information demanded. Companies can appoint auditors other than the retiring ones in general meeting only if previous notice has been given to the latter.

The annual statement to be filed with the Registrar is to be in the form of a balance sheet in so far as it relates to the state of the company, but curiously enough it need not include a profit and loss account.

General meetings are to be held at least once a year, and not more than 15 months after the previous meeting. For a poll a motion by at least three shareholders is required; this number may be increased to five. When a breach of duty on the part of the directors is caused merely by negligence, the Court may relieve a director partly or wholly of his liability, if he has acted honestly and reasonably. Lastly, the Act declared that the issue of debentures on bearer shall be valid in Scotland, where under an ancient Act its validity was doubtful. In England their validity had never been questioned.

The Act was to come into force on 1 July 1908. It was from the beginning intended to consolidate its provisions with the unrepealed provisions of former Companies Acts. The Act of consolidation (8 Edw. VII, c. 69) was passed on 23 December 1908, and thus the Act of 1907 was in force for six months only. The Act of 1908 formed a comprehensive code of company law and with minor amendments it remained in force until 1929.

With the introduction of private companies the extension of corporate enterprise was complete, and from 1908 onwards the Annual General Return of Companies published by the Board of Trade shows not only how companies were evolving, but also gives a picture of the recurrent cycles of prosperity and depression in every sphere of industrial and commercial activity.

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15. German Company Legislation between 1871 and 1900

According to the Prussian statistician E. Engel the aggregate capital of the companies which existed in Prussia, the leading State of Germany, in 1870, amounted to 1,026,172,954 thalers, or roughly £150 millions. Of this amount railway companies represented over 70 per cent., mines nearly 12 per cent., insurance

companies about 8 per cent., banks nearly 4 per cent. The share of industry was slight.

With the abolition of government charters by the law of 1870 company formation was facilitated throughout Germany. Moreover the large French war indemnity was a powerful incentive to economic expansion. In a short time a veritable boom developed. Many new companies were promoted, and the capital of existing ones was greatly increased. In the four-and-a-half years from July 1870 to December 1874 new companies were formed with a total capital of 1,102,274,675 thalers, exceeding that of all companies created up to 1870. Of this amount railways accounted for 259,337,500 thalers, that is to say the proportion of railways fell to less than 25 per cent., as compared with more than 70 per cent. in the earlier period. The share of mining companies, 131,651,628 thalers, was only slightly greater: that of insurance companies, 9,709,000 thalers, was insignificant. For new banks, however, the amount was 279,522,814 thalers, and for building companies 132,178,050 thalers, a sign of disproportionate speculation in securities and in land, especially building sites.

Many of the new companies were unsound, their formation being due rather to speculative considerations than to economic necessity. In many cases exorbitant prices were paid to vendors; speculation on the Stock Exchanges was rampant. The simultaneous boom in Vienna collapsed in the spring of 1873; Germany followed in the autumn. Many companies became bankrupt and were wiped out. Every section of the public suffered severe losses. Many instances of reckless promotions, and some of equally reckless and dishonest management, were disclosed. Indignation was strongly voiced in Reichstag and the Press. The state of company law was held responsible for the abuses, and a comprehensive reform loudly called for.

But the Government moved cautiously, and reform came only in 1884, nearly eleven years after the collapse, when the depression was nearing its end. The slump had been extremely severe, and new promotions grew scarce. During 1876–9 the number of new registrations in Prussia was only about 45 per year.

The enactment of 1884 maintained the structure of the code of 1862, which had also been followed in 1870. Its basis was the regulation of the *commandite par actions* (K.A.G.) and the provisions which applied to companies proper, or *Aktiengesellschaften*,

were treated as amendments to the general rules contained in the section dealing with the K.A.G.s.

This method, besides making the application of the law difficult, was in no way justified, since the importance of the *commandites par actions*, in both numbers and capital, was constantly declining in comparison with that of companies proper. But only in 1892 did a prominent German lawyer, Staub, in his Commentaries on the German Commercial Code, make the interpretation of the law regarding Aktiengesellschaften his main concern.

The law enacted that K.A.G.s may have bearer shares on the same conditions as Aktiengesellschaften, i.e. after full payment. The minimum size of share in both types of companies is substantially increased. For the future shares in general are to have a par value of at least 1000 marks (about £50). In companies where the shares are nominative and their transfer is dependent on the company's assent, shares with a par value of at least 200 marks (£10) may be issued. The same applies to companies with some object of public interest or which are guaranteed by public bodies, but even in those cases the shares are to be nominative.

In order to make the personal liability of partners in K.A.G.s effective, they must bring to the *commandite* a contribution of at least 10 per cent. of the share capital, unless it exceeds three million marks, when a participation of 2 per cent. is sufficient.

The main reform concerned company formation. If shares were issued for cash before the registration, at least 25 per cent. of the par value was to be paid, as against the 10 per cent. previously required.

At least five members are to act as incorporators and to draw up the articles. If these five members take up all the shares, the company may be registered immediately. Otherwise the law lays down a very complicated procedure, the so-called successive creation or formation of companies; this procedure, owing to an oversight in drafting, was not extended to K.A.G.s.

Should a company acquire property, whether for shares or for cash, the valuation is to be examined by the managers and the board of supervision. In case of conflicting interests on the part of the managers or members of the board, an examination is to be made by auditors appointed by the local Chamber of Commerce. All provisions and conditions regarding such

property are to be included in the articles and to be accepted by the original shareholders both in case of a simultaneous formation, i.e. one where all the shares are taken up by the promoters, and in that of a successive formation, i.e. when part of the capital is to be obtained from subscribers. The same is to be done in cases where property in excess of 10 per cent. of the existing capital is to be taken over within two years after the registration of the company.

Compulsory provisions as to balance sheets were strengthened by the enactment that securities quoted on a Stock Exchange or having a market price are to be accounted at the quoted market price or at the purchase price, whichever is less. But securities acquired as long-term investments may be accounted at their purchase price less depreciation, without regard to the quoted or market price. Other assets were not to be accounted at more than their purchase price.

The law introduced the legal reserve into German company legislation. The premiums obtained from subscribers on the issue of shares are in all cases to be put into the legal reserve. Furthermore the company is to put 5 per cent. of the annual profits into the legal reserve until this reaches 10 per cent. of the capital. This reserve is to be applied exclusively to cover losses in any subsequent year.

The law retained the "management" (*Vorstand*) as the company's executive organ. This may consist of one manager or of several, as provided by the articles.

The correct interpretation of the law of 1870 was that not only *commandites par actions* but *Aktiengesellschaften* also were to have a board of supervision. But there were some doubts about this, and the law of 1884 expressly requires such a board in all cases. This board is to consist of three members at least. The members (*Aufsichtsräte*) are to be elected by the first meeting for one year, and subsequently as the articles provide, but not for more than five years. It was re-enacted in greater detail that they are to check and supervise the management, may request information from the managers at any time, and are entitled to entrust examination or investigation to any member of the board, but may not delegate their powers. In practice, however, such boards of supervision acted rather by giving advice and directions to the managers in matters outside the limits of current business than in control and investigation. Even where they were active their activities were usually

but moderate. The managers in most cases endeavoured more and more to act independently, and to consult the board of supervision as seldom as possible.

This state of affairs was a matter of frequent discussion among both jurists and economists, especially after the new century had begun. One well-known economist, R. Passow, asserted that originally German companies had had two different organs, namely the managers as executives and the board of directors (*Verwaltungsrat*), an advisory body which gave directions to the managers and fixed the general lines of business policy. German legislators had, however, adopted from French law the institution of the *Conseil de Surveillance*, intending it to be identical with the *Verwaltungsrat*, and accepting the French name. It was owing to this mistake that the *Aufsichtsrat* had come into the terminology of the German Commercial Code and of the Company Law of 1870. But this does not correspond with the facts. The German Commercial Code, making the *Aufsichtsrat* compulsory for *commandites par actions*, defined its duties quite clearly, and the same was done by the laws of 1870 and 1884 for both types of companies.

German law clearly required that the board of supervision should act as a check on the management and supervise it in every respect. In most cases the supervisors did nothing of the sort; rather, they gave directions as to business policy, and even that on a decreasing scale. This was due to two factors. The board of supervision could not exercise effectual control because in most cases its members lacked the necessary knowledge, skill and accounting experience. On the other hand they were not over-active in directing business policy, partly because business was too complicated and many-sided, especially in the case of large companies, partly because the active power of control slipped into the hands of the managers. But this is only a general statement; in some cases the boards of supervision retained control, and the directors were merely their executives. Especially was this the case when the board of supervision included the holders of the majority, or at least of a substantial proportion, of the shares.

The purchase by a company of its own shares was expressly prohibited. This prohibition was absolute, however, only as to interim shares, and fully paid up shares could be purchased by the company in execution of orders for clients (*Kommissions Geschäft*). Consequently dealings in the company's own shares remained

concentrated in the hands of the companies themselves. This was especially the case with banks.

More protection was given to minority shareholders. Every share must carry a vote. The articles might limit voting rights in cases where shareholders owned more than one share, but not otherwise.

Shareholders representing at least 10 per cent. of the capital were empowered to require investigation of the company's affairs, and this retrospectively for two years, provided that they could furnish *prima facie* evidence of dishonest or gross violation of the law or the articles of the company. They were liable for damages, however, if the request was malicious.

One-fifth of the share capital was granted the right to bring an action against managers, members of the board of supervision, promoters or other persons who caused damage to the company in connection with either promotion or management. The shareholders must prove that they had held their shares for at least six months previous to the action. They had also to deposit them and to give security for damages. The rule that a malicious request involves liability for damages was extended to such cases. Lastly it was provided that shareholders representing 5 per cent. of the capital may call for a general meeting to discuss any matter they may put on the agenda, without the company being able to oppose the convocation.

In contrast to these provisions the pre-emptive rights of shareholders in case of an increase of capital by the issue of additional shares are made dependent upon the general meeting. It had formerly been usual to insert in the articles provisions securing either for all shareholders or for those specifically named, or sometimes for promoters though not for shareholders, the right to take up shares if and when the capital was increased. In certain cases even the issue price of the new shares was fixed, e.g. at par, though generally this was left to the company in general meeting. In the case of prosperous and expanding companies these rights were valuable, and in certain cases secured substantial financial advantages. It was felt that the existence of such pre-emptive rights was apt to impede the company in regard to new issues, and that their abolition would promote the securing of higher issue prices. The law now made any provision aimed at giving pre-emptive rights for future issues of additional shares inoperative as against the company. This meant that the shareholders in

general meeting had power either to grant pre-emptive rights or not, regardless of the articles. It was claimed that this enactment had retrospective force, and that pre-emptive rights existing before the law of 1884 were similarly inoperative. The Courts, however, did not accept this view, and the position thus was that previously existing pre-emptive rights were respected. The value of these rights was in some cases very substantial. Thus the German General Electric Company (A.E.G.) which on the creation of the Berlin Electric Light Company reserved the right to take 50 per cent. of any new issue at par, made up to 1906 a profit of 13 million marks on the additional shares.

Lastly the law gave more efficient protection by providing sterner penalties for offences.

The law of 1884 thus brought with it many important improvements, especially in securing honest dealing in the matter of promotions. This part of the law remained in force after the later reforms. In other respects the changes were not so fortunate, the virtual abolition of pre-emptive rights for the future later proving disastrous to minority shareholders, whereas on the whole the so-called minority rights remained on paper, owing to the restrictions set up by the imposition of liability for damages.

This law introduced into Germany the action by shareholders to invalidate the resolutions of general meetings if they were contrary to law or to the articles, though such actions were not unknown even previously. Ownership of a share at the time of the general meeting gives a right of attack. The action, however, must be based on a violation of law or of the articles; whether the resolution is beneficial to the company or not is irrelevant. Furthermore shareholders, if present at the general meeting, must declare their objection in order that it may be recorded in the minutes. The action itself is to be brought before the Court within a month after the general meeting, the share being deposited with the Court throughout the proceedings. These restrictions might not seem substantial obstacles to attacks, but the company was empowered to demand security, and the liability imposed for damages in case of malicious actions was quite unknown to the general rules governing civil proceedings in Germany. The dissatisfied shareholder was obviously not too popular with the legislator of 1884.

The strict provisions of this law proved too heavy for the smaller enterprises. At the time of its drafting it had been

suggested that an easier method of securing the privilege of limited liability than incorporation for small and medium-sized enterprises should be allowed. This was done by the enactment of the Law on Companies with Limited Liability (*Gesellschaft mit beschränkter Haftung*, or G.m.b.H.) in 1892, which made it possible to form companies without observing the stringent provisions of the law of 1884.

It is significant that the law neglected to protect the company effectively against mismanagement. G.m.b.H.s were also freed from the provisions of company law as to publicity of balance sheets and profit and loss accounts. But they were compelled to attach the letters G.m.b.H. to their name, in order to prevent any confusion with companies proper (A.G. and K.A.G.), and were prohibited from issuing share certificates. Shares in the G.m.b.H. need not be equal; their transfer was to be effected by notarial declaration recorded by the company. Any transfer was to be dependent upon the assent of the G.m.b.H. or of its manager or managers. A board of supervision was not required, but could be provided for in the contract of association, if the members chose. The only guarantee for creditors and the general public is the provision that the shareholders (members) of the G.m.b.H. are liable as joint and several debtors for the payment of the company's capital.

The introduction of the G.m.b.H. was strongly advocated, especially by business men; it was favoured on the whole by the Government and its legal advisers, but was opposed by some prominent jurists, who had misapprehensions as to the solidity of this type of corporate enterprise. It soon became very popular in Germany, mainly for those smaller enterprises which had been in the mind of the legislator, but incidentally for larger units also. The flexible legal form made its use possible for various purposes, among others for pools, cartels, and all kinds of business combines.

A systematic codification of commercial law became necessary in connection with the enactment of the German Civil Code (1896). In 1897 a new Commercial Code was passed, coming into force on 1 January 1900, which included the law on A.G.s and K.A.G.s, but not that on G.m.b.H.s. From a technical point of view the Code brought an important change. It no longer began with the regulation of K.A.G.s, but with company law proper. The number of material alterations of the existing law was large;

but they were mainly minor technical improvements, clearing up obscurities and settling doubts. Real reforms of major importance were few.

Among those few it should be mentioned that companies were now authorised to provide in their original articles for recurrent contributions in goods. The German beet sugar industry was mainly carried on by companies whose shareholders were landowners who undertook to deliver the sugar beet they produced to the factory. Before the new Code this was arranged for by way of special contract made with each of the shareholders. Now this obligation could be imposed in the articles; delivery of the goods became an obligation of company law, not of contract.

Protection for minorities was extended. Shareholders representing 10 per cent. of the share capital, instead of 20 per cent. as before, now became entitled to claim damages in representative suits from persons liable to the company (members of the board of management or supervision, promoters and so on).

Some of the reforms, however, were rather futile. Thus any shareholder became entitled to receive a special invitation to general meetings, but only if he had deposited one share with the company, which he very seldom did. It was enacted that when the fees of the board of supervision, the *tantièmes*, are fixed by the articles as a percentage on the profits, that percentage is to be reckoned on so much of the profit as remains after a dividend of 4 per cent. is earned on the share capital. This provision did not exclude the payment of fees fixed on some other basis, e.g. a specific sum regardless of profits. The most significant point was the regulation of pre-emptive rights. The Code declared that shareholders have by law an inherent right to take additional shares when issued. By resolution of the general meeting, however, this right may be denied.

The new regulation brought the K.A.G.s close to the A.G.s. On the other hand the requirement imposed in 1884 upon the partners to take a participation proportionate to the share capital was waived. Partners were allowed to take shares with all the rights and obligations of shareholders. Their position became in many respects similar to that of members of the board of management (*Vorstand*).

We should mention that by the German Law of Exchange (*Börsengesetz*) dealings in shares were strictly regulated. Shares

of companies with a smaller capital than one million marks could not be admitted. On making application to the Board of any Stock Exchange, companies had to submit their accounts, i.e. balance sheets and profit and loss accounts, for at least one year. Every application was subject to the scrutiny of the Board of the Stock Exchange, which in turn had to work under the supervision of a State Commissioner. This Board had the power and the duty to refuse the application if full information had not been given, or there was suspicion of deceit or foul play.

It is worth while to review the evolution of corporate enterprise in Germany, which after 1871 became the leading economic unit on the European continent. We must first recall that from the middle of the eighteen-seventies a very significant change had occurred in German economy. The railways, originally in the main private enterprises and those without exception companies (*Aktiengesellschaften*), were from about 1875 onwards gradually nationalised, with the result that by 1910 only about 6 per cent. of the lines remained in private hands. On the other hand the corporate system invaded industry. Even in mining the old companies incorporated as *Gewerkschaften* began to play a secondary part in comparison with the *Aktiengesellschaften*. In other branches of industry a large number of new enterprises were created as joint-stock companies, and private concerns were converted into companies, although quite a number of old establishments continued to exist as one-man firms or partnerships. According to an estimate made by Schmoller in 1887 one-third of German industry was owned by corporations.

Another point of interest is the large part played by banks in corporate form, and a relatively large number of banks were created in the form of K.A.G.s. Thus one of the oldest and most successful banks, the Diskonto-Gesellschaft of Berlin, originally formed by D. Hansemann, the famous politician and economist, in 1855, as a sleeping partnership with himself as sole owner, was within a short time converted into a K.A.G., and retained this form of structure. This example had some distinguished followers, with the result that banking companies played the greatest part in maintaining this form of business corporation, which came to take a secondary and eventually quite insignificant place in other fields of economic activity.

According to Schmoller's estimate there were in 1883 about

1300 companies in Germany (A.G.s and K.A.G.s together) with a capital of 4000 million marks, or about £200 millions; in 1890 about 3000, with a capital of about 5000 million marks, or £250 millions. This is quite a substantial increase, even if compared with the paid-up capital of English companies, estimated for 1884 as £475 millions. The nineties brought rapid development, and Schmoller estimates the number of companies existing in 1900 at between 4000 and 5000, with a capital of 8000–10,000 million marks, or £400–500 millions.

The first official statistics of companies for the whole of Germany were published in the *Statistical Yearbook* for 1908. The number existing on 31 December 1906 is given as 5060 A.G.s and 108 K.A.G.s, their capital amounting to 13,848·6 million marks, with reserves amounting to 2737 million marks. Of these companies 523 (480 A.G.s and 43 K.A.G.s) were banks, with a paid-up capital of 3738·8 million marks, and only 65 railway companies with a capital of 303·3 million marks.

The years 1907–10 show only a slight increase in numbers and capital. On 30 September 1909 there were 5222 companies (A.G. and K.A.G.) in existence, with a paid-up capital of 14,737 million marks, and reserves amounting to 3846·1 million marks. The first official statistics of G.m.b.H.s show for 1910 16,508, with a paid-up capital of 3538·5 million marks. This new form of corporate enterprise thus exhibits substantial progress both in numbers and in capital.

The German Central Office for Statistics published data for the years in question regarding the changes both in numbers and in capital of companies, and in respect of a large number of companies a summary of the financial results also.

Year	*New Companies*	*Capital in Million Marks*	*Net Increase, Companies*	*Capital*
1908	151	162,528	37	12,419
1909	179	230,796	72	45,574
1910	186	241,335	73	33,052
1911	169	235,829	45	82,791
1912	182	246,326	81	154,540
1913	175	216,841	65	41,535
1914	119	322,222	19	21,958

During the same years the capital of existing companies was substantially increased by the issue of additional shares. After

deducting diminutions due to reduction of capital the net capital increase amounted in—

1908	to 403,840	million marks.
1909	,, 460,960	,, ,,
1910	,, 535,425	,, ,,
1911	,, 536,596	,, ,,
1912	,, 702,858	,, ,,
1913	,, 354,069	,, ,,
1914	,, 501,840	,, ,,

For company profits the official data are as follows:

Year	*Number of Companies*	*Capital (million marks)*	*Reserves (million marks)*	*Net Profit after Deduction of Losses (million marks)*	*Dividends (million marks)*
1907–8	4578	12,758·55	2660	1,279·94	1,022·60
1908–9	4579	13,200·57	285864	1,114·52	959·70
1909–10	4607	13,721·04	301310	1,287·64	1,043·90
1910–11	4680	14,227·56	325453	1,393·71	1,133·30
1911–12	4712	14,880·44	357543	1,476·52	1,220·93
1912–13	4773	15,501·32	378039	1,656·37	1,332·31

It may be said that up to 1914 corporate enterprise was successful, and that in spite of financial reverses and slumps both the numbers and the capital of companies were increasing.

Very significant is the rate and proportion of reserves. Although under the law of 1884 legal reserves had only to be strengthened by appropriations from profits up to 10 per cent. of the nominal capital, and over and above these appropriations only the share premiums were compelled to be put into reserve, the open reserves of German companies were in substantial excess of these two items.

The strengthening of reserves indicates a sound financial policy, as does also the fact that additional shares were generally issued at a premium, which under the compulsory provision of company law strengthened the reserves of the companies.

Unsound promotions became exceptional, especially in the case of A.G.s; with G.m.b.H.s they were more frequent. Simultaneous promotion was the rule; successive formations were exceptional.

Incorporators (*Gründer*) were mostly previous owners or capitalists who took substantial blocks of shares. In nearly all promotions banks—both joint-stock and private firms—took

part, though they were in many cases not *Gründer* since under German law the original incorporators, and all persons who contributed property to the company, were regarded as *Gründer* and liable as such. Such a transfer of properties was in many cases made in the process of formation, either the whole capital of the company being issued as consideration for the property, or the shares being issued partly for property and partly for cash. There were cases, however, in which all the shares were issued for cash and the company purchased the property subsequently. This was sometimes done even where the company was formed solely to take over some industrial, trading, or banking establishment.

In order to prevent abuses in case of postponement of the purchase, the law of 1884 provided that the same procedure is to be observed if property is taken over within two years of the company's registration.

Promoters in German practice undertook substantial obligations. Since expenses of organisation might not be accounted as capital expenditure under German law, incorporators and promoters had in most cases to pay all expenses, formation taxes, and the fees charged for permission to deal in shares on the Stock Exchange. There were also cases where a company was created with a surplus of 10 per cent., in order to evade the obligation to apply 5 per cent. of its profits to legal reserve. On incorporation previous owners frequently bound themselves not to compete with the company in the business sold. In some cases the company had the right to re-sell certain assets to the previous owner within a certain period. Even a guarantee of profits for a fixed number of years was usual, and a guarantee for true valuation of properties sold to the company was not infrequent.

Before 1884 it was usual to stipulate for profitable rights as consideration for the promotion. After the law this became rather exceptional. Siemens and Halske, however, on the creation of the Berlin Electric Tramway Company, stipulated a 25 per cent. share in profits, after a dividend of 8 per cent., as consideration for the franchise and services. There were also cases in which promoters secured for themselves some capital payment, after the par value of the shares had been repaid in case of liquidation. To secure pre-emptive rights in case of the issue of additional shares was less usual.

From 1884 onwards promoters of new companies had not

much chance of selling property at exaggerated prices, nor could they reserve pre-emptive rights for themselves. A formal stipulation for part of the profits was apt to impair the placing of the shares. The normal profit to be made was the placing of the shares with the public at a premium. The difficulty then was that the shares could not be admitted to the Stock Exchange before publication of the first balance sheet and profit and loss account. In German practice banks, on issuing a prospectus and offering shares to the public, were careful to declare that they did not guarantee that permission would be granted. It was therefore better to delay the placement until the permission was obtained.

In some exceptional cases the previous owners kept the ordinary shares themselves and placed the preferred shares with the public. Thus Stollwerk and Co. placed cumulative but not participating preference shares with the public, reserving the right to redeem them at any time at 120 per cent. The preference shares were not secured by mortgage pledge or other security, but the company bound itself not to mortgage its assets over 60 per cent. of their value. The preference shares were on the bearer, ordinary shares nominative and transferable with the assent of the board.

The capital structure of most companies was simple. As a rule there was only one class of shares. The issue of preference shares, apart from cases of reconstruction, was usual with railways, trams and public utilities, but they were seldom found in mining and industrial companies. The practice of controlling the company by the issue of shares with plural votes was not yet in use. But sometimes partly paid shares were issued with full voting rights, thus securing control for a favoured group with a 25 per cent. investment.

In the long-remembered case of the Hibernia Coal Mining Company the group in control moved to increase the capital by the issue of preference shares with a priority up to 4 per cent. in dividends, but otherwise not participating. The issue was at par, with exclusion of pre-emptive rights, and the shares were to be taken over by the bankers of the majority group. Since the current price of the shares was high, the issue was likely to make acquisition of the majority by purchase of shares extremely difficult, if not impossible. The resolution of the general meeting was contested; the Reichsgericht, however, held it to be valid.[1]

[1] R.G.Z. 68, 244.

In the case of larger companies general meetings were as a rule dominated by banks. The shares were mostly on bearer and nothing further was required to exercise the vote. German banks had on the whole rather more control and influence over industry than those of other countries: they invested in shares, and corporate industrial units had frequently and to a large extent to resort to banks for the satisfaction of their financial needs. The practice of using their customers' shares for voting at meetings enormously increased this influence.

The banks were in a position to secure advantageous terms for their credits and an influential and profitable role in respect of issues of additional shares. Even where pre-emptive rights were not disregarded, the banks were able to obtain commissions by forming guarantee syndicates, or by taking over the issue with the obligation to offer part or all of the new shares to existing shareholders at an increased price. Moreover banks claimed and obtained seats on the boards of supervision, and there were few industrial companies on whose boards one or several leading banks were not represented. Thus the Gelsenkirchner Mining Company had three bank managers and three private bankers on its board, the A.E.G. (the German General Electric) three private bankers and six bank managers.

On the other hand the control of companies' affairs by general meetings was never very popular in Germany. In early times there are said to have been no regular general meetings at all, and they were mainly a result of the influence of the Code de Commerce. Even in relatively late days a leading South German bank, the Bayerische Hypotheken und Wechselbank, had no provision in its articles for general meetings, and its affairs were controlled by a committee of the sixty largest shareholders. The right to attend and vote at general meetings usually depended upon the ownership of a certain number of shares, e.g. two or more, but cases are recorded in which the ownership of twenty shares was required—small shareholders being thus excluded. After the law of 1870 this was altered: every share gave a right to attend and vote at the general meeting, and the supremacy of the general meeting was acknowledged in accordance with the letter and spirit of the law. In especial it was recognised that shareholders in general meeting have power to give directions to the management and to the board regarding the general conduct of affairs and particular transactions. The Supreme

Court, in a judgment of 3 May 1902,[1] declared that management and board would be wise to consult the general meeting before entering upon risky transactions. This decision, however, was not looked upon with favour. On the contrary a doctrine began to grow up that the general meeting is not called to conduct business, that shareholders should refrain from giving directions, and even that the management and the board have the right to disregard instructions aimed at interfering with the conduct of business, for which these two organs are responsible. This lack of influence was on the whole the typical characteristic of German general meetings. We are not therefore surprised to find that small shareholders did not as a rule attend general meetings and that the attendance lists at the meetings were mostly short in numbers of shareholders, and low in the proportion of capital represented. Unfortunately exact data in this respect are scarce. Passow ascertained the attendance in the case of three German banks for consecutive years.

	1903 (*per cent.*)	1904 (*per cent.*)	1905 (*per cent.*)
Deutsche Bank . . .	18·32	20·75	21·39
Dresdner Bank . . .	9·29	12·13	14·57
Darmstädter Bank . . .	5·42	4·35	8·15

For industrial companies there are no particulars. We must remember that the banks' practice of depositing the shares of their customers was already well established.

The articles of most companies left the fixing of dividends to the general meeting. In most cases, therefore, the majority had power to pay or not to pay dividends, and there was no action if they were withheld. Many managements, however, did not even go so far as to disclose the effective results, and resorted to the device of hidden reserves. Most popular was the writing off of fixed assets. Thus A.E.G. successively wrote down the value of its plants to one mark each, so that the giant establishments of this company were valued in the balance sheet at 16 marks. On inquiry at one of the general meetings it was revealed that they had cost over 32 million marks.

The drawbacks of this practice are obvious. Balance sheets giving the cost price of fixed assets were entirely misleading.

[1] Holdheim 12, 197.

No shareholder could ascertain their real values, or whether depreciation was allowed for or not. Only those with inside information could come to reasonable conclusions as to value, and consequently as to profits. Nevertheless, despite all criticism, the practice was maintained, and moreover information was given only sparingly in yearly reports and at general meetings, although the law gave minorities the right to demand disclosure. The reasons given by managements for declining information were mainly that disclosure might be made use of by rivals, actual and prospective, and might incite the setting up of new competitive undertakings, strengthen demands for higher wages, and possibly lead to State interference. Objections to balance sheets and profit and loss accounts were highly unpopular.

On dispersal of ownership no exact data are available. Passow rightly complained of this gap in German statistics, which however continued up to the end. It is true that the prevalence of bearer shares made it extremely difficult to ascertain facts; the lists of shareholders who attended general meetings could not provide exact information, especially in view of the banks' practice of depositing the shares of their clients in their own name. But even these lists were never made the subject of study. It is therefore a matter of conjecture how ownership of German companies was dispersed.

Passow assumes that each of the leading companies had at least two managers, i.e. members of the board of management. In big companies the board of managers had many members; boards of nine were not unusual. In the case of large companies deputies were generally appointed in addition to the regular members of the board; these (*Stellvertretende Vorstandsmitglieder*) had the same legal position, duties and liabilities as the full members. The only difference was in status and salary.

The real managers, i.e. the full and deputy members of the board of management, are to be distinguished from employees who held the title of "director". Where there were several members of the board, it was usually necessary to decide on some rules of procedure as to their work. In some cases one of the managers was made leader, either as chairman of the board, or with the title of "general manager". In the case of the largest companies managements worked in committees.

The appointment of managers was generally entrusted by the articles to the boards of supervision. The same boards were

empowered to remove them, but usually only by a specific majority. Appointments were generally for from three to five years, and it was usual to give managers contracts fixing their salaries and other emoluments. They usually received also a percentage on profits, the so-called *tantièmes*. By law these might be paid only out of such part of the profits as remained after providing for depreciation and compulsory reserves.

In many cases the articles provided that the managers must deposit qualifying shares; but these did not amount to much. In the case of K.A.G.s the requirements were higher. In the Diskonto-Gesellschaft a participation of 30,000 marks, in the Berliner Handelsgesellschaft one of 25,000 marks was required. A reminiscence of older times was that the partners in the Norddeutsche Bank had a participation of 1,200,000 marks, whereas its capital amounted to 30 million marks.

The theory of the law was that the managements should be subject to the authority and control of the board of supervision. In practice however many variations were to be found. Where the managers had substantial shareholdings, especially in comparison with the board's interest in the company, their position was the stronger one. Influential individuals could secure themselves independent positions even without large holdings. Furthermore, although contracts were for short periods, they were usually renewed. Managers on retirement often joined the boards, and fathers and sons, or other near relatives, were sometimes found together on the same board.

About 1907 there were still remnants of the method in vogue before 1870, when, as already explained, the usual organisation was a board of administration. This board directed the company's affairs, and appointed one or several managers. Under the Law of 1870 several companies retained their board of administration, though they had to appoint a council of supervision according to the law. Even in the case of those companies which had no board of administration, but only a board of supervision in addition to the managers or the board of management, the supervisory board in fact exercised the functions of the *Verwaltungsrat*, i.e. it fixed the general policy, directed the managers in their executive work, and gave them advice and support in case of necessity. The legal obligation of checking and supervising the management took only second place, and hardly even that.

With the growth of companies, control by the board of supervision seems to have become weaker. It is significant that it became usual for members of the board of management to join the board of supervision after retirement. In some cases, such as that of the Leipziger Kreditbank, which became bankrupt through granting disproportionate credit to an industrial combine for the development of an immature invention, it became obvious that members of the board of supervision had connived at financial mismanagement to such an extent that they were quite unaware of the loss of the company's entire capital.

Another factor connected to some extent with the growing power of managers was that the rights of minorities did not operate as the legislation of 1884 intended. Investigations were few. Actions at the instance of 20 per cent., or after 1900 10 per cent., of the shareholders were even more exceptional. Actions to invalidate resolutions carried in general meeting were more frequent, but less so than might have been supposed. The guarantees by which the law protected companies against shareholders' actions were too strong to make such actions easy. The necessary quorum of 20, 10 or 5 per cent., as the case might be, was not easy to obtain, the risk of expense and damages and the possibility that security would be required by the companies acting as strong deterrents. Public opinion and the financial press on the whole favoured the managements, and it was easy to depict shareholders who took such action as grumblers or blackmailers.

The strengthening of the position of managers, both in law and in practice, was also apparent in their improved social and financial position. During the first half of the 19th century they were looked upon as inferior in status to the members of the *Verwaltungsrat* or *Aufsichtsrat.* Thus we learn that in the eighteen-forties L. Camphausen, later famous both as an economist and as a statesman, refused to accept the post of general manager of a railway company because he regarded it as an inferior one. But from the seventies managerial posts gradually became more and more important. In banks and large industrial concerns the managers were the real bosses, and the *Aufsichsräte* had to be content with minor roles.

Whether this was a necessity or an abuse was a frequent matter of discussion. There were experts who maintained that a higher measure of duty and liability should be introduced for

the members of the boards of supervision, and that they should be compelled to fulfil the obligations of their office. Others stressed that it was in practice out of the question to call for actual supervision from them. Even the examination of the yearly accounts was a very hard task, and a thorough scrutiny of them by every member of the board was practically impossible. This was especially the view of experts from the boards of banks and other large companies. Others suggested that individual members should have the right to examine the books, records and accounts, or that special committees should be appointed for this purpose. In actual fact large companies employed accountants for the work of supervision, and there were several companies, called Treuhandgesellschaften, created by leading banks, whose special purpose it was to undertake audits and periodical examinations of company books and accounts.

The board of supervision had usually more members than the board of management. Thus that of the Deutsche Bank had 27, of the Dresdner Bank 33 and of the Gelsenkirchen Mining Company 26.

Passow undertook to investigate from what circles these boards were recruited. He found that they consisted of large shareholders, or such as had been interested in the company at its formation and were retained on the board, although they had sold their shares; bank managers or bankers who played a part in the formation or were giving credit to the company; experts of every kind, technical, commercial and legal, titled persons, retired civil servants or officials, and retired managers of the company. He admits further that there was certainly some degree of nepotism in the selection of the boards. In consequence there were individuals who occupied posts on more than one board; this was especially true of bank managers and private bankers. According to private investigations four big banks delegated 141 individuals, who occupied altogether 861 posts on boards of management and supervision. Even in this early period there were persons who held seats on a large number of company boards. According to Passow, a private banker of Cologne was sitting in 1905 on the boards of 33 companies. At the same time four managers of the Deutsche Bank had 11, 17, 20 and 22 seats, three directors of the Dresdner Bank 18, 25 and 29; two directors of the Diskontogesellschaft 16 and 18; one director of the Berliner Handelsgesellschaft 24; one director of the Schaffhausen Bank

30; three delegates of the banking firm of Bleichröder 14, 15 and 15 seats on boards of supervision respectively. Whether this was necessary or beneficial for the companies may be questioned.

The fees of the supervisors were fixed by the articles. The law of 1897 provided that in so far as they took the form of a share in the profits, they were payable only from what was left after providing for depreciation and reserves plus a 4 per cent. dividend on the share capital. But this provision did not prevent the fixing of fees on any other basis. It was never exactly ascertained how much of companies' profits was actually taken for the payment of boards of management and supervision. A private inquiry made by the banker Loeb showed that in 1899–1900 the *tantièmes* paid by German companies amounted on an average to 0·6 per cent. of their capital, or in industrial companies to 0·75 per cent. Salaries are not included. According to Passow's investigations of a small number of leading companies, *tantièmes* varied widely, owing to the regulation imposed by the law. Thus in the case of the Hamburg-Amerika Line they absorbed in 1902 0·79 per cent., in 1903 2·33 per cent., in 1904 4·99 per cent. of the profits.

No particulars, however, are available regarding the total burden on companies of the salaries, fees and other emoluments of the two boards. Incomplete occasional details show that payments to managers were relatively high. Especially was this the case with the big banks incorporated as K.A.G.s. It was alleged that some managers were enabled by their emoluments—salaries, *tantièmes* and other compensations—to earn substantial amounts, and to invest in, and even acquire large blocks of, shares in their own companies.

In spite of these adverse circumstances we may assume that corporate enterprise in Germany was on the whole a success, and that even though managements may have taken more than their share and exercised exaggerated powers, yet shareholders also enjoyed substantial advantages, and if investment in company shares was popular it was not without good reason.

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16. American Business Corporations and Corporation Law from 1865

At the end of the Civil War the United States was faced with a fundamental change in economic conditions. The Southern defeat ensured the supremacy of the industrial North, whose productive capacity had vastly increased during the war. On the other hand liquid assets were incomparably greater. There was undoubtedly inflation caused by the liberal issue of paper money and transferable war bonds. These means were used for the opening up of the West by the construction of the transcontinental railroads, which before the war the South had opposed.

From the point of view of corporate enterprise the age of transcontinental railway building is remarkable in several ways. The railways were heavily subsidised both by Federal and State Governments, by grants of land on an unimagined scale, and also by monetary allocations. It is estimated that in the period 1850–1871 railroad corporations received 159 million acres from the Federal Government, and from State Governments about 55 million more. In monetary grants the Union Pacific received $27,236,572, and the Central Pacific $27,855,562. These vast grants were to some extent justified by the risks of the schemes. None the less the construction and management of these railways displayed gross abuses. One was that the promoters and directors formed special construction companies, keeping the stock for themselves and their associates, and making contracts with the railroad disproportionately favourable to the construction company. The most conspicuous case was that of the Credit Mobilier, formed for the construction of the Union Pacific. Its profits were said to have amounted to 2750 per cent. on its original stock. Construction costs were in consequence extremely high, and were increased by the expense of the bribery then rampant. They were met by over-capitalisation. The companies issued bonds secured by mortgages and stock to amounts far in excess of the

real costs. Capturing the fancy of the gullible public by clever advertisements, they were able to place bonds and shares alike, securing vast profits for themselves.

The term "watering the stock", attributed to the notorious speculator Daniel Drew, originally a cattle drover, who is alleged to have practised watering before delivery of the cattle he sold on weight, was first applied in reference to manipulations of Erie Railroad securities, but it was used on a gigantic scale in connection with the Pacific lines. It is not surprising that the first adverse traffic results brought defaults of dividends and consequently collapse of prices of the securities involving great losses for the investors.

Simultaneously with the construction of the Pacific railroads there was an expansion of other lines, and subsequently consolidation. The earlier railroads had been mainly short local lines, but now adjoining lines were constructed or purchased, mergers effected, and longer routes covered by one company. These transactions involved similar abuses. Not only the American, but also the European investor was heavily victimised by stock watering. It is said that Gould and Fisk, who dominated the Erie Railroad, issued on this 17-million railway 71 million dollars of watered stock within six years. The operations of these "Robber Barons" were not restricted to promotions; they constantly manipulated the companies dominated by them by bear and bull speculations and in some instances sucked them dry. Immense, ill-gotten private fortunes were made in this way, while the general public lost vast sums. The railroads, however, were built.

Simultaneously the carriage of goods developed on a large scale, carried on mostly by undertakings on corporate lines, the so-called express companies. Telegraphy was opened up in the U.S.A. by business corporations, the largest of which from the beginning was the Western Union, which in 1880 had already 85,645 miles of line.

In the industrial field likewise the end of the Civil War marked a definite stage. In 1859 the total value of manufactures was roughly 1·9 thousand million dollars (1,886,000,000); in 1869, after hardly five years of peace, it had grown to 180 per cent. of this, or $3,386,000,000. In 1889 it was $9,372,000,000, 500 per cent. of the pre-Civil War volume. The size of the units was on the increase. In 1859 the average industrial unit had a

capital of $7,190, produced goods to the value of $13,420, and employed 9·3 wage-earners; in 1899 the averages were: capital, $19,269; turnover, $25,418 and wage-earners, 10·4. The twelfth census of the U.S.A. in 1899 gives 512,254 producing units with products valued at $13,004,400,143, of which only 40,743 were corporations; but these produced 59·5 per cent. of the total product.

Both in railways and in industry and commerce there was unbridled competition. The railways pursued a policy aimed at attracting traffic by every means where competition existed, and at imposing every possible charge where it did not. The Government refrained from interfering; but this situation could not continue. The railways themselves began to consolidate; on the other hand public opinion demanded regulation of rates, particularly the taking of strong measures against discrimination by rebates whether open or secret, the latter practice furnishing the darkest spot of railway policy.

As to the forms and methods of consolidation—the only point with which this work is concerned—the usual procedure was the lease or outright purchase of railroads; in some cases mergers took place, in others purchase of stock under special enabling Acts. In this way vast combinations of railroads and, subsequently, real systems of connected lines, came into being.

In industry excess of competition led to temporary arrangements, sometimes national, more frequently local in character. At a later stage the need of stronger organisation became urgent. This was met by the ingenious application to industrial combinations of the device of the trust.

The procedure was briefly as follows: the owners of all or of the majority of the stock of several corporations transferred their shares to trustees, who for their part issued trust certificates to the stockholders. The ownership of the stock was vested in the trustees, who were therefore in a position to appoint the directors of the corporations and to fix their business policy, while the original stockholders were to receive their dividends and capital repayments—if any—on the basis of the trust certificates. These certificates were transferable, so that the holders could sell their interest in the same way as they had previously been able to dispose of their shares.

The formation of such trusts made it possible to direct the corporations included in them as a single unit, to impose on them

a consistent business policy, to eliminate competition between them and to pool their earnings. The trust was able to wage war against outsiders by reckless undercutting, leaving them the choice between joining the trust and ruin.

The first instance of the use of this device for industrial amalgamation was the Standard Oil Trust, formed by John D. Rockefeller and his associates in 1879 and reorganised and improved in 1882. In this latter and fully developed form, which was due to the ingenuity of T. G. Dodd, Rockefeller's legal adviser, 40 companies were united, representing 90–95 per cent. of the oil-refining capacity of the nation. One hundred per cent. of the shares of some of the corporations, and a majority of those of others, was transferred to nine trustees who issued 700,000 trust certificates of $100 par value. Among themselves the trustees controlled 466,280 certificates, four of them holding a majority. It is obvious that an exceptionally strong organisation of the industry under an effective leadership was thus made possible.

The example of the oil trust was soon imitated. Within a few years the American Cotton Oil Trust, the Linseed Oil Trust, trusts of distillers and cattle-feed producers and the Sugar Trust of the sugar refineries had come into operation. The name of "trust" came to be adopted as a technical term for such combinations.

Public opinion felt that the common weal was threatened by these trusts, and its misgivings led in 1890 to the passing of the Sherman Act. Under this Act and certain State Acts, proceedings against some of the trusts were started. The results were not far-reaching.

Meanwhile, however, a new device was invented: that of the holding company, with which we shall deal shortly in connection with the State legislation concerning it. The holding company was thought to be safe from the Sherman Act, and many of the trusts were transformed into such companies by one of the member corporations, or a new corporation, purchasing the stock of the others. The holders of shares in the various corporations, or of the trust certificates, received shares in the holding company. In some cases the company confined itself to holding the shares, in others it operated one or more plants itself.

Largely as a result of this device, in 1904 183 industrial combinations were recorded with a capital amounting to nearly

$3,200,000,000, while Moody mentions for the same year 318 industrial trusts, operating about 5300 plants.

The rapidity of the increase becomes obvious if we recall that in 1890 only 24 trusts are reported with $436,000,000 capital, and that of the 183 combinations mentioned 120 had been formed during the past three years.

Public opinion was not at all satisfied by anti-trust actions. Under the presidency of Theodore Roosevelt, and even more under Taft, new proceedings were started, this time against trustifications through holding companies.

The judicial and administrative policy in respect of industrial combinations is the subject of another volume in this series. Here we need only state that the Supreme Court of the U.S.A. took the view that the Sherman Act may be violated by purchase of stock in other companies, if the material premises of the Act are present, and that therefore a holding company may be dissolved under the Act. This view was adopted in the case of the Northern Security Company *v.* U.S.,[1] in 1904, and was followed in Standard Oil Co. of New Jersey *v.* U.S.,[2] in 1911, and in American Tobacco Company *v.* U.S.,[3] in the same year.

At the same time recourse was had to mergers in an increasing number of cases. Later, however, it was held that the anti-trust legislation applied to these also and to amalgamation and purchase of all assets, and that corporations might even in such cases be subject to anti-trust action.

What contribution was made by the legislature and the Courts to the struggle against the domination of American economic life by trusts and mergers is altogether doubtful. The most prominent legal factor after the Civil War was that statutory legislation was furthered, while the duality of Federal and State legislation remained on the whole unaltered.

As we have seen, the Federal Constitution did not contain any provisions with regard to corporations. Thus, on a strict interpretation Congress had no express power to create corporations, while at the time of the enactment of the Constitution a general regulation of corporation law was not envisaged. But at an early period it became necessary for Congress to create corporations in order to exercise one or another of the functions the Constitution conferred upon it. The first instance of such a Federal corporation was the Bank of the United States. For the

[1] 193 U.S. 197. [2] 221 U.S. 1. [3] 221 U.S. 196.

regulation of currency the creation of a central bank was deemed necessary, and in spite of adverse opinions the first Bank of the United States was incorporated by Congress. The constitutionality of this Act was contested, but in McCulloch *v.* State of Maryland [1] its validity was upheld by the Supreme Court in virtue of the doctrine of implied powers. The same view was taken by the Court in Osborn *v.* Bank of the U.S.[2] It has been held that this view is valid even to-day, and that Congress has authority to organise corporations as a means of exercising any function conferred upon it by the Constitution, and may grant to such corporations all powers appropriate for the purpose. By virtue of this power Congress may create corporations out of public funds, or with their capital partly furnished from private sources, but it may also create privately owned corporations, provided their purpose conforms with the general principles aforementioned. Thus the authority of Congress extends to the creation of corporations engaged in inter-State or foreign commerce. Actually this has been done in respect of transport and other means of inter-State communication.

The implied powers of Congress also extend to the enactment of general regulations. Such a general enactment operated for National Banks. The constitutionality of the original National Bank Act and its amendments has been repeatedly upheld by the Supreme Court.

In connection with National Banks the question of the limits of Federal legislation has been discussed in several directions. The Federal Reserve Board has been empowered to give authority to national banks to act as trustees, executors, administrators and registrars of stocks and bonds, provided such power is not contrary to the law of the State in which the bank is incorporated. In virtue of this power State legislatures cannot prohibit National Banks from acting as trustees, and so on, unless banks in general, i.e. State Banks also, are forbidden by State law to act in that capacity. Though this was disputed, the decision was that States may not discriminate against National Banks in this regard. To do so would involve interference with the authority of Congress.[3] It may be mentioned that Federal land banks and joint-stock land banks were brought into existence by Acts of Congress.

[1] 4 Wheat. 316 (1819).
[2] 9 Wheat. 738.
[3] Cf. Smith *v.* Kansas City Title and Trust Co., 255 U.S. 180 (1921); Burnes National Bank *v.* Duncan, 265 U.S. 17 (1924).

The power of Congress to incorporate does not, however, mean that there is a Federal agency for incorporations. All corporations created under an Act of Congress must be incorporated in one of the States or in the District of Columbia. Their powers may be, and in fact are, defined by the Act under which they were created.

The limits of the power of Congress are not in every respect quite clear. Thus it is disputed whether Congress may grant a corporation power to engage in intra-State commerce as an incident to its proper purposes, or whether a manufacturing corporation engaged in shipping its products in inter-State commerce could incidentally distribute such products in the State where they were manufactured. Earlier it was held that the Federal Courts have exclusive jurisdiction in suits brought against Federal corporations. It is now settled that actions against corporations created under an Act of Congress are subject to the general rules in respect of jurisdiction.

Until the New Deal, the powers of Congress to enact general rules and regulations were sparingly exercised. The New Deal legislation will be discussed in § 22. Even to-day (1948), however, Federal legislation does not extend to corporations in general, and corporations not engaged in inter-State commerce, or not using inter-State mails or other means of inter-State communication, are not covered by it.

At the time of the emergence of trusts, legislative steps were repeatedly suggested. W. W. Cook, a corporation lawyer of great renown, suggested Federal legislation as a remedy. In his view a Federal incorporation law could do a great deal against abuses. The suggestion had no success. His other suggestion, that trusts should be compelled to incorporate, was likewise not acted upon.

All the State legislatures themselves sooner or later enacted general incorporation laws. Some of them operated by special Acts for various classes of corporations, and later evolved systems of regulation for corporations generally. Others took the opposite path, enacting general regulations with special rules for special classes, such as banks, railways, insurance companies, public utilities and so on. These laws, though differing in many details, show a strong tendency towards *laisser-faire.* Not only in that, apart from cases where the subject of the enterprise called for the grant of a special franchise by the legislature or by some administrative body, corporations could be freely formed, but

even as to their legal framework, more and more liberty was granted to incorporators. It was increasingly left to them to regulate the corporation according to their own wishes. This tendency became irresistible in consequence of competition between the States to attract incorporations.

The initiative in this respect was taken by New Jersey, where the Legislature took a step of great importance not only for that State but for the whole of the U.S.A. Company taxation was low; railway companies especially enjoyed very favourable taxation rates. For many years any property outside the railroad itself was practically exempt from taxation, and it was only gradually that in the eighties just assessment was secured. It was asserted that a substantial part of the corporation-owned property situated in the State paid little taxation, and to this the financial plight of the State was attributed. An ingenious lawyer, J. B. Dill, put forward the suggestion that in order to stabilise its finances the State should combine two steps, namely, impose franchise taxes on corporations, though within moderate limits, and on the other hand liberalise the law and in this way make New Jersey incorporations popular in other, especially the big industrial, States. The basis of this arrangement already existed in that the requirement to carry on business within the State itself was dispensed with. The idea was accepted, and a series of amendments to the law made between 1888 and 1893 freed the way. The most important was the grant of the power to acquire and hold shares in other corporations, and to influence their management. This was the foundation of the holding company as the instrument most appropriate for the formation of industrial combinations.

The opportunities afforded by New Jersey legislation at once became known to interested industrial and financial circles. Moreover, under Dill's initiative, a corporation was formed for the special purpose of acting as a go-between for New Jersey corporations. In this way even smaller units could incorporate themselves in New Jersey, since for a small fee the incorporating agency furnished all facilities, especially a head office as required by the State legislation. By 1900 the Corporation Trust Company of New Jersey had 1200 corporation head offices in their building; another corporation established at Camden had 700.

By about 1900, of 121 corporations with capitals exceeding $10 millions, 61 were incorporated in New Jersey and only 60

in other States. Further, of the so-called 81 lesser trusts 64 were New Jersey corporations, as were the largest combines, such as the U.S. Steel Corporation and the Standard Oil Company. Dill and his supporters had attained their aims. New Jersey had a large share of incorporations, and though taxes were moderate, the State was able by 1902 to wipe out the whole of its indebtedness.

The grant of such wide facilities of course influenced corporation law in most of the States. Every State which imposed strict regulation ran the risk of putting corporations to flight and keeping away incorporators of new undertakings. Moreover New Jersey was among the States which kept up longest the stand against anti-trust legislation. In 1897, in view of the prosecutions in the first phase of the anti-trust movement, it refused to recognise any foreign law, or to enforce the provisions of any such law, as to the personal liability of directors, officers and shareholders, penal or contractual. With the awakening of the public conscience, however, agitation for reform became powerful, and under the governorship of Woodrow Wilson in 1913 the so-called Seven Sisters laws were passed. These Acts made possible anti-trust actions before the State Courts. Their enforcement, however, was not too energetic, and in 1917 the law was considerably weakened, company law becoming substantially the same as it had been before 1913. In the meantime some other States had become envious of the financial advantages to be gained by liberal corporations laws, moderate taxation and effective propaganda.

From 1910 onwards, competition in this respect became lively and effective. The most active of the States was Delaware. In 1899, when its corporations numbered only 421, that State adopted the principle that corporations have power to purchase and hold stock in other corporations, and extended the rule to the effect that they may take part without any restriction in the management of those corporations. At the same time the formation of corporations was facilitated in every way, in order to attract incorporations by enterprises situated and carrying on business exclusively outside the State. The financial burdens were also lowered to considerably less than the New Jersey level. In 1900 incorporation fees jumped to \$70,740, whereas the franchise tax yielded \$8318. In 1915 incorporation fees brought in \$117,389 and the franchise tax \$94,723. The relative importance

of this source of income becomes clear if we note that the total revenue for that year amounted to $857,904, so that nearly one-quarter came from this source.

Subsequently certain other small States resorted to similar practices. Delaware, however, maintained its position as probably the most popular State for incorporation.

This competition between the States prohibited every tendency to impose stricter regulations upon corporations, and in this way American Statute law became increasingly lenient as to both the creation and the management of business corporations. The extensive power of directors, already well established, became recognised within even wider limits. The holding company was everywhere accepted.

In 1912 a new type of corporate structure was recognised by New York: the corporation with shares of no par value. The example was followed elsewhere, though its heyday came only after the First World War.

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17. French Legislation from 1893 to 1914

As we have already seen, it was not until 1893 that French company law was amended. The amending enactment, while leaving the basic provisions of the 1867 law untouched, introduced the principle that all companies, whether *commandites par actions* or *anonymes*, are to be regarded as merchants whether they are engaged in mercantile business or not. Until then companies whose purpose was not of a mercantile nature were called "civil" companies. The distinction was mainly technical: civil companies were not subject to bankruptcy proceedings in case of insolvency. From 1893 onwards they could be made bankrupt with all appropriate consequences, especially those of the penal law thereto attached.

The amendments introduced by the law presented a very complex feature. The minimum par value of shares, both for *commandites* and for companies proper, was substantially reduced.

Companies with a capital not exceeding 200,000 francs were to have shares with a minimum par value of 25 instead of 100 francs, and those with a larger capital shares of at least 100 francs par value instead of 500. On the other hand the provision that bearer shares might not be issued before full payment, abolished by the law of 1867, was restored. It was also provided that shares issued for *apports* (consideration other than cash) should not be transferable during the first two years, and were to be endorsed to this effect. The liability of the transferor of nominative shares was to cease after two years.

As we saw earlier, companies had full freedom to make voting rights dependent on a fixed minimum holding. As a consequence, small shareholders were deprived of votes. Under the new law members with holdings smaller than the required minimum were permitted to unite in order to vote through a representative (*Droit de groupement*).

The characteristic remedy of French company law, the action for nullity, which could be brought by any interested party, whether shareholder, creditor or otherwise, led to great abuses. It was sometimes used as a powerful weapon to extort money from the company. The law of 1893 restricted this right of action in two directions. No action for nullity was to lie if the defect in question has meanwhile been amended, or, where to amend it a resolution in general meeting is necessary, if such meeting has already been convened when the action is brought before the Court. Furthermore, no such action might be brought after ten years.

Thus the new provisions made company law stricter in some respects; on the other hand some of them, especially the reduction in the minimum par value of shares, made participation in companies easier for the small investor, and in this way tended to enhance speculation.

French legislation seemed disinclined to adopt codification on a large scale, or to take a clear-cut line either by making company law less stringent, or increasing guarantees to the public against abuses and malpractices. This curious situation continued for a long time.

The next step in company law reform was taken only in 1902, although in the meantime quite elaborate drafts were presented. The new law contained only a minor amendment. It permitted of the issue of preferred shares in companies (*anonymes*). Such

shares might carry priority rights as to dividends and distribution of net assets; unless the articles provided otherwise, preferred and ordinary shares were to have equal voting rights. Where a general meeting was convened to decide on an alteration in the rights of the different categories of shares, special meetings of the affected shareholders were to be held. Lastly the two-year term during which *apport* shares might not be transferred was to apply in case of mergers only if the companies concerned were of less than two years' standing.

The law was obviously drafted with less than the necessary care, and the Courts, in applying its provisions strictly, made its defects very cumbersome in practice. Consequently a new law to amend them was passed in 1903, making it clear that not only *anonymes*, but also *commandites par actions*, could issue preference shares. Furthermore, to remove doubts, it was enacted that the issue of such shares might be resolved upon by companies already in existence before 1902, their issue being prohibited only if the articles expressly so provide. Priorities in distribution in the event of winding-up might be granted. Lastly, the two-year limit for *apport* shares was relaxed, so that they could be transferred even if only the absorbing company was over two years old.

In 1913 the power of general meetings was extended to any alteration of the articles, with two exceptions, namely that the company's nationality must be preserved, and that an increase of the obligations of shareholders to the company could be effected only by a majority resolution. At general meetings convened for such purposes it was provided that each share should carry a vote, regardless of any restrictions in the articles, and that the votes should increase in proportion to the holdings. On the other hand a quorum of three-quarters and a majority of two-thirds were required for a valid resolution. For other meetings of companies, where the necessary quorum was not present, a new general meeting might be held at which 50 per cent. of the shares should form a quorum, and if such quorum was not present at the second meeting, a third might be held after 15 days, for which the quorum was reduced to one-third, but all these general meetings were always to pass resolutions by a two-thirds majority.

In 1913 it was further found necessary to declare that the provisions of the law of 1893, permitting the formation of groups

for the exercise of votes, were to apply also to companies created previous to that law.

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18. British Companies under the Companies Act of 1908

THE ACT OF 1929

The Companies Act of 1908 remained in force for nearly twenty years. Under it corporate enterprise conquered every field of business activity. Until this Act was passed, the invasion of industry and trade by corporations was fairly slow, in spite of their constant increase in numbers and capital. The new impetus was mainly due to the fact that legislation now recognised the private company as a special class.

Before the Act the private company was not unknown. From about 1880 onwards cases increasingly occurred where the owner of an undertaking turned it into a company, mainly with the intention of limiting his own liability and securing the future of the enterprise in case of his death. He retained control through ownership of the shares, making up the necessary number of seven shareholders by friends or nominees. The same was done in case of partnerships. These private companies were characterised by the control and ownership being in the hands of one or a few shareholders; transfer of shares was necessarily barred or restricted. The Companies Act of 1862 had made it possible so to frame the constitution of a company as to adapt it to such special needs. The number of such companies was not inconsiderable; but the real boom in private companies came with their recognition as a special type.

We must remember that it was left to the choice of the incorporators whether the company should be formed as a public or private one. It could be private if the number of shareholders did not exceed fifty, if the transfer of shares was made dependent upon the company's assent, i.e. that of either the directors or the shareholders, and lastly if it did not appeal to the public for capital. Although the private company form was obviously meant for small or medium-sized undertakings, the Act did not make the amount of the capital a matter of discrimination. A small company could be formed as a public company, and a large capital was no obstacle to the formation of a private one.

Under the Act of 1908 it became possible to transform an already existing public company into a private company, or vice versa. A conversion of the latter form was necessary if the company wished to abolish the restriction on the transfer of shares, or intended to make an issue to the public. It became automatically necessary if the number of shareholders came to exceed 50.

Originally there was no intention of discriminating between public and private companies in regard to publicity, i.e. the filing of the yearly balance sheet with the Registrar. In the House of Lords, however, an amendment was accepted to the effect that a private company need not file its balance sheet. Consequently a third person could not ascertain from the register or from the documents filed with the Registrar more than the memorandum and articles of association and the names of the directors and shareholders.

Of the 5024 new registrations in the year 1908, 3078 were private companies. In the same year 16,172 public were converted into private companies, while only six private companies were converted into public ones.

To appreciate the place of companies in the economic life of the nation we must note that on 30 April 1909, 46,474 companies existed in Great Britain with a paid-up capital of £2,163,789,000. According to one estimate,[1] company debentures amounted to £400–500 millions. The number of new registrations and their nominal capital are shown in the following table:

Year	*Number of New Companies*	*Nominal Capital (£)*
1908	5024	104,441,189
1909	6373	141,630,296
1910	7184	212,975,689
1911	6444	157,303,062
1912	7367	174,004,837
1913	7425	157,186,653
1914	6214	113,257,583
1915	4062	53,354,606
1916	3393	50,442,871
1917	3963	67,873,926
1918	3504	127,879,495
1919	10,725	412,967,204

It will be noted that apart from the boom of 1918–19 the average size of newly registered companies was diminishing.

[1] *Journal of the Institute of Bankers*, vol. 31, p. 2.

The other significant trait partly contributing to the reduction of the average nominal capital is the increase of private companies. At the end of 1919 nearly 50 per cent of the existing companies were private companies. This absolute increase in numbers is even more accentuated with regard to the new registrations of the year 1919. Of the 10,725 new registrations 9729 were private companies. From the point of view of solidity it is to be remarked that in contrast with the nominal capital of £412,967,204 only £23,235,364 was paid in cash, whereas £19,650,520 was represented by contributions of assets (vendor's shares and the like). Altogether not more than 10 per cent. of the nominal capital of the new registrations of that year was paid up in cash or otherwise.

Meanwhile there was but incidental new company legislation. 3 & 4 Geo. V, c. 25 (1913) provided that private companies are to lose their privileges if they fail to comply with the requirements of the Act. The Court, however, was empowered to grant relief if the failure was inadvertent or merely accidental, and generally should it be found to be just and equitable. It was provided also that present and former employees are to be disregarded when counting the number of shareholders, in arriving at the maximum of 50. Thus a company may remain a private one if any excess of its members over fifty is due to the participation of present or former employees.

Several Acts introduced wartime measures in connection with Trading with the Enemy legislation. Of these, 7 & 8 Geo. V, c. 28 (1917) providing that the nationality of directors who are not British is to be disclosed, remained permanently in force. Apart from this legislation was inactive, and although in 1918 a committee presided over by Lord Wrenbury made a number of suggestions they were not followed up.

The boom which extended throughout 1920 was followed by a slump and a long depression. The ensuing recovery, beginning in 1925, produced figures of new registrations approaching those of the years 1919 and 1920 both in number and capital.

During this whole period the private company remained in the ascendant, and at the end of 1929, of a total of 108,698 companies in existence, 16,922 were public and 91,776 private. The total nominal capital was £5,200,126,998, of which public companies represented £3,697,934,162, and private £1,502,192,836. The average nominal capital in 1920, at the deepest point of the

Year	Number of New Registrations	Nominal Capital (£)
1920	10,783 (including Ireland, 11,011)	587,484,721 (including Ireland, 593,189,032)
1921	6834	107,214,586
1922	8495	131,729,895
1923	8466	113,944,466
1924	8464	123,208,601
1925	8529	132,202,608
1926	8288	214,365,448
1927	8850	185,734,653
1928	9522	236,523,194
1929	9099	240,422,640

depression, was £13,459, and in 1929, at the height of the cycle, £26,423.

Until the slump public opinion was not keen on company law reform. But the depression brought to light quite a number of fraudulent promotions, as well as evidence of mismanagement. A committee was appointed under the chairmanship of Mr. Wilfrid Greene, K.C.[1] After hearing a large number of legal and financial experts it presented its report in 1925. This contained a long list of suggestions. Only a part of these, however, were adopted by the Act 18 & 19 Geo. V, c. 45 (1928).

In view of the number of amendments needed it was intended from the beginning to consolidate company law. This was done by 19 & 20 Geo. V, c. 23, which incorporated the contents of the previous Act and came into force on 1 November 1929. The former Act was, apart from some provisions, never in force of itself.

The number of amendments made was large, though not all of them are of great importance.

The adoption of high-sounding names and such as might otherwise be apt to deceive the public was prohibited. This salutary provision did not prove quite satisfactory in practice.

In view of the practical need for amalgamations and other arrangements it was enacted that companies may by special resolution insert a clause in their articles giving power to sell the whole undertaking, or to amalgamate.

It was provided that an alteration of the memorandum increasing the liability of shareholders is not binding on dissenting shareholders. This was obviously merely declaratory of the existing law.

In order to make more effective the rule against purchase by

[1] Now Lord Greene, Lord of Appeal in Ordinary.

the company of its own shares, the giving of financial assistance for such purchases was prohibited.

The rights of minorities were protected by a provision that where there are different classes of shares a minority representing at least 15 per cent. of the shares of any one class may apply to the Court for relief against resolutions impairing their rights. Companies were empowered to issue redeemable preference shares.

The Act lays down more specific rules with regard to books of account, especially as to the form and contents of the balance sheet. Special rules are introduced with regard to subsidiary companies. But all these rules were shortly found not to meet the growing requirements of practical life. *Inter alia* the attitude of British law to the profit and loss account, the importance of which it disregarded, remained unchanged.

The Act aimed at preventing abuses in the concealment of directors' adverse interests, and also provided that all loans and remuneration to directors were to be disclosed. The latter rule, however, was qualified by the far-reaching exemption from disclosure of salaries or other remuneration paid to directors in some other capacity, as managers, consultants and the like. At the same time it was doubtful whether the rule providing that directors must disclose their interests to the Board was sufficient to protect the company.

The position of auditors was strengthened by a provision that they are entitled to attend general meetings at which the accounts of the company are to be considered; and not only officers of the company, but partners also, were declared ineligible for appointment as auditors. Strangely enough, however, these protective provisions were not extended to private companies.

With regard to winding-up it was provided that where in the course of liquidation offences committed by directors or other officers come to light, the Court may institute proceedings through the Director of Public Prosecutions.

A new departure was taken by the provision that any agreement with directors limiting their liability is to be considered void. The same prohibition applies to auditors.

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19. French Legislation after 1913

Although legal and economic opinion agreed on the necessity of a thorough-going company law reform, the Parliamentary machine was unable to cope with the need, and contented itself with enacting minor amendments; which constituted only an accidental patchwork, with many uncertainties and obscurities. It would be futile to analyse these ephemeral pieces of hasty legislation, and it will suffice to point out some relatively important steps.

In 1913 the powers and procedure of extraordinary general meetings were regulated anew. This law was later amended in 1930.

In 1919 the institution of the commercial register was introduced and applied to companies.

In 1925 a new type of company with limited liability (*société à responsabilité limité*) was regulated as a kind of private company, influenced to some extent by the German legislation on the G.m.b.H.

The law of 1930 mentioned above, concerning the extraordinary general meetings, was amended in 1935 by an Order by which the provisions as to the balance sheet and profit and loss account were regulated. By the same Order, and another of 1937, the method of appointment and functions of the commissioners for supervision of the accounts were laid down.

A law of 1933 regulated the vote at general meetings, amending the law of 1867; this was amended by the legislative Order of 30 October 1935, already mentioned, whereas the legislative Order of 8 August 1935 related to the pre-emptive rights of the shareholders.

The question of so-called Founders' shares, i.e. profit-sharing certificates issued in favour of incorporators, was settled in 1929. These had been in use for a long time; it was enacted that such certificates do not give the holder the legal position of a shareholder.

This picture of French company legislation is neither consistent nor bright, and it is not surprising that among the countries occupied by Nazi Germany during the Second World War, France succumbed to a wide extent to the influence of German ideas, otherwise so foreign to French jurisprudence.

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20. British Companies under the Act of 1929

Robert Lowe (Viscount Sherbrooke), whose name is so intimately connected with company legislation from 1855 to 1880, said that it is a misfortune of company law that the Acts amending or codifying it are passed in times of great excitement. With equal justification it may be said that all the Acts examined in the preceding review of English company legislation were after a short time, in many cases even immediately, followed by a financial crisis, which showed up their deficiencies in more than one direction.

The most conspicuous case is that of the Act of 1929. As official statistics show, 1928 was a very prosperous year, with new registrations involving a nominal capital of roughly £236·5 millions, and 1929, or at least its first three-quarters, was even more so. 9990 new companies were registered with a nominal capital of £240,422,640, or nearly £4 millions more than in 1928.

The collapse on the New York Stock Exchange in the autumn of 1929 was at once felt in all other stock markets, London among them. Many old and new companies failed, and the crash was undoubtedly one of the factors which caused Great Britain's abandonment of the gold standard in September 1931.

Statistics for 1930 and 1931 clearly show the extent of the crisis. New registrations in 1930 covered 8866 companies with a nominal capital of £112,259,379; those of 1931, 8797 companies with a capital of £65,058,209. Moreover, the Macmillan Committee Report [1] states that the total amount of £117 millions subscribed by the public for shares and debentures in 284 public companies was reduced on 31 May 1931 to about £66 millions. In other words nearly 50 per cent. of the amount subscribed was lost.

Even more remarkable is it that 70 of the 284 companies mentioned were liquidated in less than three years, while the securities of 36 others had no ascertainable value. The total loss to the public in these 106 companies amounted to £20 millions.

Corporate enterprise nevertheless showed a slight growth, since the capital actually invested in shares of public companies increased from £3,893,937,840 to £3,896,668,416 in 1931, and

[1] P. 66.

in 1932 decreased but slightly, to £3,879,754,552, while for private companies the increase was uninterrupted:

1930	£1,590,511,832
1931	£1,618,105,485
1932	£1,657,236,217

The crisis brought to light many grave abuses in the form of reckless statements in prospectuses and of mismanagement or concealment, especially in the accounts of groups of companies.

Company reform was demanded on various sides. Mr. Horace B. Samuel's sharp analysis [1] is worthy of special mention. But the year 1933 showed a beginning of recovery in the economic and financial field, and neither the Government nor Parliament felt the need for interference.

From the year 1933 new registrations in England and Scotland were as follows:

Year	*Number of Companies*	*Nominal Capital (£)*
1933	11,936	94,954,522
1934	12,953	148,029,517
1935	13,613	143,365,007
1936	14,260	164,422,038
1937	13,220	120,302,501
1938	13,132	75,196,466

Throughout all this period the capital invested in private companies showed not only an absolute increase, varying with the special circumstances of each year, but also a relative one in comparison with that invested in public companies. Thus in 1934 the capital invested in public companies decreased from £3,870,644,549 to £3,850,666,935, whereas the paid-up capital of private companies increased from £1,691,785,278 to £1,696,683,212. Years of greater prosperity of course brought increases in the paid-up capital of public companies also, but the increase for private companies, both in numbers and in paid-up capital, was the greater. At the end of 1938 there were 14,355 public companies in existence in England and Scotland with a paid-up capital of £4,096,805,588, and 143,221 private companies with a paid-up capital of £1,893,738,013. The corresponding data for 1939 and the following years were not published, and the blackout has even now been only partially lifted. We know, however, from official sources,[2] that at the

[1] *Shareholders' Money*, London, 1933. [2] Cohen Committee Report, 48, p. 26.

end of 1939 the number of public companies was 13,920, and their paid-up capital £4117 millions, while at the end of 1944 the figures were 13,300 and £4052 millions respectively. There was therefore a decrease both in numbers and in paid-up capital. New registrations were not able to make up for the extinction of companies by liquidation or otherwise.

In contrast private companies increased both in numbers and in capital. In 1939 there were 146,735 private companies with a capital of £1923 millions; at the end of 1944, 169,205 such companies with a capital of £1935 millions.

These changes may be attributed in part to Government control of capital issues, which weighed more heavily on large than on small enterprises, formed mainly as private companies. Otherwise the trend with regard to public companies was rather towards a decrease in numbers and an increase in average size, while in the case of private companies there is an absolute increase both in numbers and in aggregate capital, but a decrease in the average capital strength.

As regards legislation, we have to mention only the Prevention of Frauds (Investment) Act of 1939, which imposes the requirement of a licence for the professional sale of securities apart from transactions on the Stock Exchange. This does not strictly belong to the sphere of company law, though its consequences affect the placement of corporate securities also. The Act came into force on 1 August 1945. It has been in operation for too short a time for any opinion on its effect to be possible.

Public opinion was mainly concerned with nominee holdings. It was observed that in general meetings a substantial part—in a few cases a majority—of the shares represented were sometimes held by nominees. A feeling arose regarding the possible danger of concealment of real ownership, especially when it was in the hands of foreigners. These apprehensions found voice in Parliament, and in June 1943 the President of the Board of Trade appointed a Committee to consider the desirability of amending the Companies Act of 1929.

Although it was the question of nominee holdings which was responsible for the appointment of this Committee, the Board of Trade gave a larger scope to its work. It was directed to report on what major amendments were desirable, and in particular to review the requirements relating to the formation and affairs of companies and the safeguards afforded for investors and the

public interest. Fifteen concrete questions were submitted to the individuals and bodies whose opinions were invited, and who presented memoranda and gave oral evidence before the Committee. The memorandum issued to these organisations and individuals thus restricted the field of investigation, and it may be questioned whether some sort of general inquiry would not have been more useful.

The Committee, under the chairmanship of Mr. Justice Cohen (now Lord Justice Sir Lionel Cohen) was made up of bankers, lawyers, and industrialists, with a representative of an important employee organisation. It received a large number of memoranda, and heard oral evidence at 26 of its 47 meetings. The material contained in the written and oral evidence is fairly exhaustive, and the various opinions and controversies received equal attention. The Committee presented its report in June 1945. The suggestions therein made will be dealt with in connection with the particular questions to which they relate; here two remarks only are to be made.

The first is that the witnesses, and even more the Committee itself, kept too closely to the matters included in the questionnaire, and many questions ripe for solution were therefore not discussed. The second is that, on the whole, the report is conservative and is obviously influenced by the undoubtedly justified conviction that the management of British companies was on the whole honest. The Committee therefore refrained from recommending fundamental alterations of the law, but suggested a number of amendments.

A Bill embodying most of their recommendations was introduced in the second half of 1946. This covered some, mostly minor, points not dealt with by the Committee. The House of Lords considered the Bill thoroughly, and many provisions were altered both in substance and in wording. It was brought down from the Lords on 1 April 1947. The debate in the Commons was short, and the amendments mainly concerned the drafting. The Lords agreed to these amendments on 5 August 1947. The Bill became law on 6 August 1947 as the Companies Act 1947 (10 & 11 Geo. VI, c. 47).

The Act consists of 123 sections and nine schedules, the first of which is a voluminous enactment of accounting rules. It covers a large number of matters and its technique is rather complicated.

There was great need for consolidating its provisions with those of the principal Act. The Lord Chancellor stated in the House of Lords on 5 August 1947 that it was hoped to introduce a consolidating Bill in the following session, and a Bill reproducing in a consolidated form the law contained in the Companies Acts 1929 and 1947 was introduced on 8 March 1948, and became law on 30th June 1948 as 11 & 12 Geo. VI, c. 38. Certain provisions of the Act of 1947 came into force on 1 December 1947 by Board of Trade Order No. 2503 of that year. The most important of these were those relating to investigations of the affairs of companies and of share ownership, to companies' names, to alteration of companies' objects and of the memorandum.

It was the intention of the Government to put the reforms in respect of accounts into force on 1 July 1948, so that business circles might have full notice of them. Many companies have begun already to make up their accounts in accordance with the new rules. The remaining provisions were not enforced pending consolidation, but consideration was to be given to requests to bring any provision into operation earlier, if to do so would be helpful to the business community. Actually, however, the Act came into force on 1st July 1948.

The provisions of the Act will be analysed below in connection with the examination of the various matters dealt with, and at the same time the necessity for further reforms will be pointed out.

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21. German Companies after 1919

Germany's defeat in 1919 fundamentally altered her position. She lost much territory, and the value of her currency fell at the conclusion of hostilities; in November 1918 the mark was worth only about 40 per cent. of its former value, and in 1919 it depreciated still further.

The census of companies for 1919 gives their number as 5714,

and their share capital without reserves as 21,035,811 million marks. But this does not show the exact position. German companies—at least those that were conscientiously managed—did not increase the valuation of their assets, especially of their fixed assets, according to the value of the mark on the date of the balance sheet. As a rule it was only current assets which were valued at current prices. The companies maintained this practice even during the further enormous depreciation of German currency. At the end of 1923 there was not one financial or industrial concern—even the biggest—whose fixed assets were valued at even one gold mark. Balance sheets and profit and loss accounts, which were more or less informative even in 1919, subsequently lost all touch with reality. Insiders alone had information about the true position of companies.

The disastrous consequences of this state of affairs soon appeared. At first uninformed shareholders were inclined to sell their shares at the Stock Exchange prices, which seemed to them very favourable, whereas in actual fact during the whole depreciation period the quotations of solid shares were mostly extremely low.

Many companies issued additional shares during the inflation. This practice tended to enhance the already excessive speculation in shares and made it possible to realise profits for the boards of management and of supervision, insiders and bankers, rather than to procure funds for the company. In many cases when a new issue was made pre-emptive rights were excluded, as was possible under the Commercial Code of 1897. If the whole or a substantial part, say, half, of the new issue were taken up by the quarters mentioned, the regular shareholder was deprived of a more or less substantial part of the value of his holding, without any real advantage to the company, since the issue price of the additional shares was in most cases far less than their real value. In these two ways, by keeping him in ignorance, and leaving him under the influence of inducements to sell out, while excluding his pre-emptive right, the small shareholder was generally deprived of his opportunity.

The inflation, it is true, induced many people to buy shares, especially members of classes never previously accustomed to such investments. But a great part of such purchases went to new companies with no real foundation, which became bankrupt by the thousand at the end of the inflation.

On the whole the holdings of the old middle class in the shares of sound companies were greatly diminished. New holders appeared, making use of the opportunity given by low prices, and acquired substantial blocks of shares for very little—if accounted on a gold basis.

The managers and supervisors became anxious, fearing infiltration by the formation of new majorities. Clever use was made of the fact that in a few cases the new shareholders were foreigners. It was easy to convince public opinion that there was a strong possibility that foreigners might acquire dominating control of the whole of German industry.

To counter these dangers, many German companies issued shares with plural voting rights. Here two alternatives were possible: firstly, new shares could be issued and offered, with exclusion of the pre-emptive right of existing shareholders, to reliable persons, say to a syndicate controlled by the management, which undertook to retain them for a fixed term of years. In this way a majority could easily be secured, all the more as in these years the payment of the par value was not a burden of any moment. It could be, and in several cases actually was, made even easier by requiring only the payment of 25 per cent. of the par value from the group in question. There was no legal objection to the grant of full voting powers to shares which were only partially paid up.

Such issues, however, were subject to attacks, since they deprived the shareholders of their proportionate interest in the company. In view of this the management by degrees made more and more use of the other alternative, the issue of a kind of preference share. German Company Law allowed preferential rights to be granted both to shares issued on the formation of a company, and to new shares issued in connection with increases of capital. It was held that such a preference cannot consist merely in a plural vote, but that a plural vote may be given if the shares carry other preferential rights also.

The usual procedure was consequently as follows: the new shares carried a preference as to dividend up to, say, 4–5 per cent., and in respect of the par value of the share in case of liquidation, but otherwise not participating, and a preferential right with regard to voting. German companies made ample use of this device, both during and after the inflation. The preferential voting rights were in many cases a multiple of the normal vote.

Besides instances of double voting rights, some are recorded in which a preference share of this kind carried 50, and in some isolated cases 500 or even 1000 votes.

The German Courts, influenced by public apprehension of the danger of foreign domination of companies, raised no objection to such nullification of voting rights, unless not only the vote but also the material participation of shareholders was impaired by the issue of shares with preferential rights. On the stabilisation of the mark the majority of German companies had issued preference shares carrying such high voting powers that even a substantial majority of ordinary shares was unable to control the company.

Although this practice originated in the desire to make foreign control impossible, it was largely used also in cases where no foreign inclination to acquisition could be observed. The managements made use of the device in cases where their fear was only that Germans outside the circle of the management and the board might acquire control. Besides the original genuine foreign infiltration, the *äussere Überfremdung*, a new name, "internal estrangement" (*innere Überfremdung*), was invented for such cases.

These two lines of action, exclusion of pre-emptive rights and the creation of shares with plural votes, made the predominance of the management and the board of supervision even more complete than before 1918. The Legislature raised no objection and the Courts, as already mentioned, interfered only in a very few cases where increases of capital amounted to crass expropriation of shareholders and confiscation of their property to a disproportionate extent.

At a later date the Nazi economic and legal experts sought to attribute these machinations to bank influence, alleging that the bankers of the companies induced the management and the board to effect capital increases in order to acquire blocks of shares, which they could sell on the booming Stock Exchanges, and so realise profits. In actual fact, however, majority shareholders and the boards of management and supervision shared at least equally in the transitory profits of new issues, while in the long run it was they who secured control even in the absence of substantial holdings.

The only legislative step taken by the Social Democratic government of Germany was the enactment of 1920 regarding factory councils, providing that these councils should have the

right to appoint one member of the board of supervision if the membership of the board was less than three, two members if it were three or more. This came into force in 1922, with the result that on the board of supervision of every German A.G. and K.A.G., and even on those of G.m.b.H.s—if they had one—one or two delegates of the factory council had seats. These members were entrusted with the exercise of the legal powers of the board of supervision with special consideration for the interests of employees. They were not to receive any fixed fees or *tantièmes*, but only their out-of-pocket expenses.

This reform of the law was heralded as an important step on the way to fundamental social revolution. In fact it met with no success. The delegates did not exercise any real power, and could not influence policy, even in the special field of employees' welfare.

Much more important were the economic consequences of the financial upheaval in the direction of concentration both of banks and industrial and trading companies. Up to 1914 the concentration and consolidation movement, already very strong, especially in the U.S.A., was in Germany almost restricted to banks. The big Berlin banks began to dominate the whole of Germany, except perhaps Bavaria. In industry independent enterprises were widespread, and competition was generally regulated not by mergers but by pools and cartels. Their position underwent substantial alteration in the years 1919–24, and in connection with the increasing number and volume of Stock Exchange transactions not only were many companies consolidated by way of mergers (called "Fusion" in Germany), but vast so-called "concerns" evolved. German legal and economic terminology gives the name of "Konzerns" to companies operating plants of their own, and at the same time acquiring actual or virtual majority holdings in other companies. About 1924 it was thought that in consequence of these two types of consolidation, the once popular and dominant type of cartel agreement would altogether cease. But this did not happen, for after the stabilisation of German currency the building-up of Konzerns came to an end, and some of them had actually to be dissolved. Nevertheless in 1924 a large number of German industrial companies were organised into big groups with interlocking shareholdings and directorates.

The years after 1919, especially 1922 and 1923, exhibited

hectic movements in the creation of new companies and increases of capital. In 1921 the net increase in the number of companies was 979, their capital amounting to 3930 million marks, and the increase of capital of existing companies amounted to 16,394 million marks. In 1922 the net increase in the number of companies was 2922, with capital of 13,854 million marks; the new issues of existing companies amounted to 40,529 million marks. There thus existed at the end of 1922 9558 companies (A.G. and K.A.G.) with an aggregate capital of 103,739 million marks. For 1923 the *Yearbook of Statistics* gives only the number of new companies, 6922, without stating their capital or the capital increases of existing companies; but this can easily be understood if we consider the astronomical figures involved, meaningless as they really were.

After the depreciation came to an end the Government in December 1923 issued an Order providing for the readjustment of company balance sheets, which were to be drawn up in gold marks, subsequently identified with the new Reichsmark. Under this Order, which was later amended and supplemented by no less than six others, German companies had to draw up as for 1 January 1924, or for whatever day in that year was the first of their financial year, a balance sheet based on a new valuation of their assets and liabilities on the basis of the gold mark, equal to $\frac{10}{42}$ of the U.S.A. dollar. Should the net value of the assets exceed the nominal value of the shares, the surplus could be put to reserve account or the capital increased either by increasing the par value of the shares, or by issuing additional shares. These two methods of adjustment, which of course were available only to organisations which had not increased their capital, at any rate to a large extent, during the inflation might also be combined. Companies which had so increased their capital had necessarily to show a deficit as compared with the nominal value of their shares. For these the method of adjustment provided was a reduction of capital or an additional payment into capital account, or both. For this adjustment a time limit of three years was allowed, provided the deficit did not exceed nine-tenths of the capital. In such a case the company was entitled to form a depreciation account and put it into the assets. This fictitious asset was to be wiped out within three years either by reduction of the capital and a proportionate reduction in the par value of the shares, or by additional

payments from shareholders. Until this capital depreciation account was written off, the company could not begin to distribute its profits. Many companies, especially those created after 1914, were not able to maintain the full par value of their capital and shares, and had to adjust their capital by this means.

In view of the great number of companies which had only a diminutive capital, it was enacted that a company (A.G. or K.A.G.) must have a capital of at least 5000 marks, and that the par value of the shares must be at least M100 in those cases where formerly the minimum was M1000, and M20 where it had formerly been M200. For a G.m.b.H. the minimum capital was to be M500, and the lowest share value M50. Companies unable to comply with this requirement were to be dissolved.

As a consequence of the readjustment of capital the par value of shares had to be readjusted also, and in view of the minima fixed, there were many cases in which the conversion of several shares into one was necessary to create a new share. The shareholders were obliged to present their shares within a period to be fixed by the company, and the company had the right to sell by public auction shares not so presented for exchange. Where a shareholder had not the number of shares necessary for the conversion, the company had to issue part certificates entitling him not only to proportionate dividends but also to votes. It could, however, call for the conversion of such part certificates after three years.

In all cases of the issue of additional shares in connection with capital readjustments occasioned by the currency stabilisation, the pre-emptive right of shareholders was fully secured, while for the future the general principle that this right depends upon a resolution in general meeting was maintained. Where in connection with the readjustment capital was to be repaid to shareholders, those concerned had the right to demand in lieu profit-sharing certificates (*Genusschein*) without votes, but these could be redeemed by the company within three years.

Readjustments were facilitated by the provision that a simple majority was to suffice for a valid resolution. In case of disputes swift and cheap arbitration methods were provided for. On the other hand the whole regulation was somewhat too tender to plural votes: their existence was not affected, and there were even facilities with regard to the par value minima for a certain class of cases.

The whole balance sheet regulation was transitory in character. One alteration, however, was permanent. Hitherto there had been no legal minimum for share capital. The only requirement to be complied with was the provision that at least five shareholders must join in the formation of a company, and that at least 25 per cent. of the par value must be paid up. A company could therefore be formed with a nominal capital of M5000 by a payment of M1250; or in the case of privileged companies with a capital of M1000 and a payment of M250. It was now enacted that in future new companies, both A.G.s and K.A.G.s, must have a capital of at least M50,000 and in the case of G.m.b.H.s of M5000, the minimum par value of the shares being the same as in the case of capital readjustments of existing companies.

German companies began in 1924 with their capital readjustments, the so-called *Umstellung*, but by the end of that year out of a total of 17,074 companies only 3508 had so far completed readjustment. Even at the end of 1925 there were still a certain number which had not finished the transaction. The catastrophe to the German currency of course slowed down the formation of new companies, and a great number of them fell victims to the cataclysm. Even in 1924, 1881 new companies were formed, but there were numerous bankruptcies (480) and liquidations (519). Three hundred and fifteen new companies were formed in 1925 with a capital of M203,355,000; 488 were liquidated, 246 became bankrupt, and 50 were dissolved for other reasons; consequently there was a net decrease in both numbers and capital. The net capital loss amounted to M450,848,000, and that in numbers to 466; besides this, 1590 companies were dissolved without having readjusted their capital.

At the end of 1925 there were 13,010 companies with a readjusted capital of M19,121 millions, and 1908 companies still had balance sheets in paper marks, i.e. had not readjusted. It is to be remembered that on the same area of Reich territory there were at the end of 1913 5129 companies with a capital of M16,527·2 millions.

The official data therefore show that as to both numbers and capital German companies successfully withstood the collapse of the currency and the consequent economic cataclysm. The vast increase in the number of companies proves that the corporate device had invaded all branches of economic activity, and that

although a large number of companies, especially those formed after 1918, had on the whole insignificant capitals, the aggregate amount of company capital showed an increase of about 15 per cent. Even more illuminating is a comparison for 3347 companies which had existed before 1914 and were still surviving. They had at the end of 1913 a capital of M12,214,537,000 and reserves amounting to M3,147,024,000. At the end of 1925 their capital was larger, namely M12,812,424,000; their reserves, however, had decreased by about 50 per cent. to M1,748,400,000.

This surprisingly favourable position was not due exclusively to economic factors. The attitude of German legislation with regard to the legal consequences of currency depreciation played a decisive part in the situation. Up till the end of 1923 German legislation did nothing to alleviate the plight of creditors, and the Courts held that creditors must accept paper marks in full settlement of debts incurred previous to the depreciation. By the time the Courts changed their view, companies had already wiped out most of their debts. At a later stage the law provided for a certain degree of re-valorisation of debts incurred before the depreciation, but this legislation was relatively tender towards corporate enterprise. Industrial bonds had to be valued according to circumstances, but not in excess of 15 per cent., and bank debts not at all.

The 4347 companies mentioned had in 1913 a bonded debt of M14,883,327,000. At the end of 1925 the bonded debt amounted only to M691,095,000. Even though the subsequent re-valorisation increased this burden to some extent, it was only a fraction of the original debt. Other debts, i.e. banking and trading debts of the said companies, amounted at the end of 1913 to M16,867,732,000; at the end of 1925 to M5,921,030,000, little more than one-third of the pre-war debt, and it is to be remembered that this amount included debts contracted after the stabilisation. Pre-war debts may be said to have been wiped out without any sacrifice at all.

Had the companies been obliged to pay their debts at their full pre-war value, most of them would have been bankrupt. Had the legislature adopted the equitable view that shareholders and creditors must bear losses proportionately, the companies might have preserved a smaller part, say, 30 per cent. on the average, of their share capital. In consequence of the method adopted by German legislation the bulk of the losses was borne

by the creditors, bonded or otherwise. This attitude is closely bound up with the economic and social doctrine evolved in Germany on the question of corporate enterprise.

As early as about 1914 it was asserted by Franz Klein, a famous Austrian jurist, that corporate enterprise has important obligations not only to shareholders but at least equally to employees and the whole community. This doctrine was further elaborated and popularised by Walther Rathenau, who united the practical experience of a leading industrialist to the deep learning of the social philosopher. In an essay published in 1917, when he was one of the greatest authorities by reason of his work in organising Germany's industrial war machine, he said that a corporate enterprise, particularly a large corporation, is an independent entity not only from a legal point of view, but also in the economic sense. A large company should not be allowed to dissolve merely because the interests of its shareholders so require, but only if and when the community does not need its further survival. It is the enterprise that matters, and not the financial interests of the shareholders. If there is a certain amount of profit, it should be made distributable only if doing so is not contrary to the interest of the undertaking, and if the profits are required to maintain or increase the financial strength of the enterprise, they should be withheld from the shareholders.

It is hardly surprising that this doctrine should have been hailed with enthusiasm by the managements of the various companies and all their camp-followers, who looked upon themselves as the real and competent defenders of the interest of undertakings as such. What is more remarkable is that the doctrine was widely accepted outside this relatively small milieu. Workers and employees, and Socialist circles in general, were also in favour of it, the former finding it to their interest that enterprises should become stronger; profits should not be distributed, but invested in the enterprise, for in that way they expected better salaries and wages. The Socialist doctrinaires for their part believed that by the strengthening of corporate enterprises the movement for concentration would be accelerated, and thus the time would be nearer when the total expropriation of the remaining small number of giant units, the final goal of Marxism, would be realised. Financial circles for their part continued their endeavours to strengthen the position of managements and boards of supervision, especially as Germany was in urgent need of

financial rehabilitation, and sought it by the issue of additional shares and bonds. This was done to a large extent up to 1928 with great success.

The years up to 1929 show a constant decrease in the number of companies, but a substantial growth in capital, due in part to the creation of new companies, but mostly to capital increases in those already existing. Data as to the formation of new companies are as follows:

Year	*Number of New Companies*	*Capital (Marks)*	*Change in Numbers*
1925	312	203,355,000	–2078
1926	231	214,026,000	–1420
1927	360	350,451,000	–1185
1928	356	329,243,000	– 576
1929	321	560,992,000	– 346

The decrease in the number of companies was due to the disappearance of those without sound financial foundation. Many became bankrupt, were liquidated, or were dissolved for other reasons. Their disappearance of course caused a reduction in the aggregate capital invested. This reduction, though in itself quite substantial, was not only made good by increases in the capital of existing companies, but those increases show, even after the deduction of the capital of defunct companies and the capital reductions of others, a substantial increase in the aggregate of German company capital.

Year	*Aggregate Net Increase of Capital (Marks)*
1925	1,125,326,000
1926	909,699,000
1927	896,765,000
1928	1,343,129,000
1929	843,378,000

At the end of 1929 there were 11,344 companies (A.G. and K.A.G.) in existence in Germany with an aggregate capital of M23,728,029,000. The financial results of the managements were not equally satisfactory. The profit rate was considerably less than before 1914.

German companies used the conversion of their balance sheets from paper into gold marks for the substantial devaluation of

their assets. Most of them, especially the larger ones of better standing, strengthened their position by creating not only open but secret (hidden) reserves. Only the open reserves of those companies whose balance sheets are dealt with in the German *Statistical Yearbook* are known. Even these were quite substantial. The 9372 companies analysed in the *Yearbook* for 1926 show, in comparison with a capital of M15,514,183,000, reserves amounting to M2000 millions. In respect of hidden reserves no data are available. Since during the years of recovery additional shares were generally issued at large premiums, reserves were strengthened, and a part of the profits was appropriated to the same purpose. The picture in 1929, therefore, seems not unsatisfactory. Closer examination, however, reveals some facts which cannot be looked upon otherwise than as a sign of inherent weakness.

For 1928 it is recorded that 1719 trading and industrial companies, i.e. companies other than banks, had a capital of M10,807,123,000 and reserves of M1,376,553,000. Bonds were issued to the amount of M2,689,970,000. Other debts amounted to M6,255,236,000. The liquid assets of these companies, however, represented only M6,285,724,000. The industrial companies in question obviously financed themselves to the extent of almost 100 per cent. by loans, largely short term; their own capitals and reserves were fully invested in fixed assets.

The situation was aggravated by the policy followed in respect of new issues. Pre-emptive rights were frequently disregarded, though to a smaller extent than during the inflation. Large blocks of shares were placed outside the country. The attraction of foreign capital was widely favoured, and was advocated both by industrial leaders and banks, and in this connection voices were raised in favour of alterations in German company law, in order to assimilate it to that of the U.S.A. The financial policies followed in the twenties in America, especially the authorised capital, the entrusting of issues and their conditions to the management, the introduction of convertible bonds, and so on, were widely recommended. On the other hand, although company leaders aimed at attracting foreign capital, shares with plural votes were retained. A record for September 1925 shows that of a number of companies whose shares were quoted on the Stock Exchange, 755 with a capital of M4,689,599,000 had no plural voting shares, while 660 with an aggregate capital of

M6,346,838,000 had them. Subsequently with some variations the number of companies with plural voting shares declined, but even at the end of 1929 47·2 per cent. of companies had them, and their capital represented 52 per cent. of the capital of all the companies in question. With regard to other companies similar data are not available; it may be assumed, however, that the ratio was not less favourable to plural votes, since such companies were not subject to the control of the boards of Stock Exchanges.

Even more illuminating is the ratio of votes granted to plural voting shares by the companies concerned.

Year	*Plural Shares Representing Percentage of Capital*	*Votes Amounting to Percentage of the Capital*
1925	2·4	38·2
1926	2·3	36·9
1927	2·8	34·9
1928	2·7	29·6
1929	2·6	27·6

It is to be remembered that shares with plural votes were always held by the directorate, that is by members of the boards of management and supervision, or by their close friends and associates. On the other hand, shares with single votes, which represented about 97 per cent. of the whole capital, were dispersed more or less widely. It was therefore possible to control companies through relatively small fractions of the capital.

There was only one factor which the boards of companies had to take into consideration, namely, the influence of banks. Shares in Germany were in many—it may even be said in most—cases deposited with banks. The larger a bank's clientele, the more shares were in its vaults. Even if a shareholder was not in debt to his bank, he generally kept his shares at his banker's. If shares were used as collateral, they had of course to be deposited with the bank as creditor. In both cases banks used the shares they held on deposit to attend general meetings and to exercise the votes attached to them. Since German shares were almost always bearer shares, no formalities were needed, and since the law required an authorisation from the owner, the banks included in their general conditions of business a clause to this effect. It was therefore not wise to make enemies of big banks, and it

became usual for managers to befriend one or several of the leading banks, even if these were not interested in the companies either as shareholders or as creditors. They were given seats on the boards of supervision, and in the event of capital increases by issue of additional shares the practice was adopted of forming a guarantee syndicate and paying commission even if all or most of the new shares were offered to and actually taken by shareholders. There were, of course, companies which were independent of banks, and even had influence on banks as important clients through deposits or otherwise. But mostly the reverse was the case, and even such companies as the German Dye Trust, the I.G.-Farben, had leading representatives of several banks on their boards of supervision.

Finally, the growth of giant enterprises became more accentuated throughout the period. The four or five leading chemical concerns, already closely connected by pool agreements, merged; the consequent formation of the I.G.-Farben A.G. marked an important step. A large part of Germany's chemical industry, with many ramifications in related branches of industry and with many subsidiaries in foreign countries, was merged into a single company, whose size was out of proportion to the total of German economy. In the heavy industries a similar giant was created by the merger of several iron and steel plants and coal mines into the Vereinigte Stahlwerke. Not all these amalgamations and combines were justified by economic reasons.

The extent to which foreign capital invaded German corporations in this period cannot be exactly ascertained. The first official estimate dates from the end of 1931, by which time presumably large blocks of stock had been already resold to Germany. The *Statistical Yearbook* for 1931 lists 3835 companies with an aggregate capital of M19,624,570,000, and shows that of this amount shares to the par value of M1,451,210,000 were held by foreigners. If, on the other hand, we compare the extent of foreign holdings with the capitals of the companies to which such holdings related, the proportion is substantially larger, amounting to about 30 per cent. of their aggregate share capital. The tendency to attract foreign capital was much over-valued, and the danger of foreign domination cannot be regarded as substantial enough to justify the creation of plural shares and the maintenance of this device.

Company law, as we have seen, was not altered during this

period; there were, however, substantial changes in company practice, which have been examined by R. Passow.[1] In his view there was a change in the direction of reducing the power of the majority.

German commercial law from 1861 onwards had been based on the democratic principle, i.e. on the power of the majority being proportional to its shareholdings. Passow admits, however, that in fact shareholders, especially those with small holdings, showed no great interest in general meetings. Again, even before 1918 German banks used shares deposited with them as collateral or otherwise for their own purposes, by depositing them in their own name for general meetings and exercising the voting power they carried. Nevertheless a majority could always impose its will upon the company.

The rule of the German Commercial Code as to the suspension of voting rights in case of self-interest [2] was intended to restrict majority rights. There were, further, frequent agreements between interested shareholders as to the exercise of voting rights. In such cases the freedom of the shareholder in question was obviously restricted, and the German Courts held such agreements valid.

The so-called rationalisation and concentration of production necessarily led to interlocking holdings. Beside those combines whose purpose was at first an economic one, the exclusion or restriction of competition, there were others where companies exchanged shares in order to secure control.

The most fundamental change, however, was the creation of shares with plural votes and similar devices, the so-called protecting shares, treasury shares, and similar artificial holdings.

It was a matter of discussion whether the issue of plural shares and similar devices was necessitated by the danger of infiltration by foreign interests. It was generally held that until the stabilisation of German currency this danger was a real one. Some experts, however, such as Schlitter, manager of the Deutsche Bank, held that even in these times it was exceptional. It was genuine, for example, in the case of the Dye Trust, I.G.-Farben, but held on the whole in fewer cases than was supposed. With the stabilisation of the currency the danger passed. A prominent Cologne banker, Hagen, therefore suggested a general prohibition

[1] *Strukturwandel der Aktiengesellschaften* (1930).

[2] § 252, 1, 4.

of the creation of shares with plural votes in future, but somewhat inconsistently advocated the retention of plural rights created in the past.

Passow rightly complained that the actual situation had never been thoroughly ascertained even by the official *Ausschuss zur Untersuchung der Erzeugung- und Absatztätigkeit der Deutschen Wirtschaft*, a commission appointed by the Reich Government. Nevertheless some facts were made clear. The so-called *Nachgründung*, or acquisition of property during the first two years after incorporation, became after 1918 more frequent. Corporate form was increasingly used for purposes alien to real business associations, as for one-man businesses, for purely publicly owned or mixed companies, for small enterprises, for companies merely holding and administering properties, for pure holding companies and for non-profit-making enterprises.

In the matter of corporate finance, every method of attracting capital was tried. Thus preferred shares of all kinds were issued, as well as profit-sharing certificates and stock dividends. Regrets were expressed that variable bonds and bonds with options were hardly if at all reconcilable with German company law.

The question of the dispersal of ownership in German companies was ventilated before the Commission, but not examined, not even the attendance lists of general meetings being studied and abstracted.

The answers of the expert witnesses were largely based on personal experience and guess-work. Schlitter said that in his opinion a larger portion of shares was held permanently, especially in concern ownership, i.e. in the hands of other companies and banks. He did not think that purchases of large blocks were due to occasional speculation. That was the case only during the inflation. After stabilisation such purchases were made by larger concerns, mostly in order to acquire a footing in companies. The question whether banks contributed to such movements was not discussed. Schlitter asserted that the creation of shares with plural votes was not necessary as a protective measure against rivalry; German banks never made use of this device, but could nevertheless maintain their independence.

It is not clear whether after 1918 the dispersal of share ownership was on the increase. No reliable data are available. Schlitter, and the legal expert Dr. Wolf, stated that the reduction of the minimum par value in 1924 had contributed to wider

dispersal. Branch managers in Berlin working-class districts said that they could find no evidence of such a movement.

Hagen suggested the restoration of 1000 marks as the minimum share value from industrial circles. Flechtheim was for the maintenance of the 100-mark minimum, Braun against it. The question whether plural shares were held by the management or by circles otherwise interested was not examined, nor was it made clear to what extent contracts regulating voting rights were in use.

On the deposit of shares with banks opinions were quite contradictory. Schlitter thought that this was less frequent than before 1918; Pinner held that it was more so; Wolf did not find any change. It was felt that managements had become more independent of the boards of supervision, but even this was not demonstrated by facts. With regard to the working of collegiate managements, i.e. boards of management consisting of numerous members, only individual opinions were expressed, no facts being alleged in their support.

It was stated that with the growth of the size of companies the boards of supervision frequently delegated their powers to committees who did the work instead of the board. As for the members of the boards delegated by the workers' councils, only the workers' associations asserted that their work was of importance; all other experts were unanimous in thinking them quite useless.

There was much dispute whether attendance at general meetings had increased or diminished. It would seem that this may have varied in different parts of Germany. In the industrial sectors of Western Germany, especially in the Rhineland, many shareholders were said to attend the meetings. Characteristically, no complaints were voiced as to the participation of banks by virtue of shares deposited with them.

There were, however, complaints of abuses by small shareholders, and it was said that in many cases shareholders with minute holdings made themselves a nuisance in order to obtain financial advantages. Concrete cases, however, were not brought forward. Passow deplored the practice of refraining from disclosure of the salaries and other compensations of managers and members of the board. Experts, however, made no complaints in this respect, and the financial journalist Buchwald was alone in asking for more publicity, and especially in describing the

objections raised to disclosure as devoid of justification. Obviously the choice of expert witnesses influenced the trend of the discussions; they were mainly bank managers, bankers and company lawyers.

Significantly it was only Buchwald who mentioned the abuse of inside information for speculation in the shares of companies, whereas it was an open secret that company managers, influential members of the boards of supervision and their friends had before 1918, and even more during the inflation, made large fortunes by speculative transactions.

As to the ideological background, Passow deplored the evolution of the doctrine of the "enterprise as such". He said, however, that the influence of Rathenau on its evolution was exaggerated. On the contrary Rathenau (p. 30) said that it is for the majority to dominate corporate life, unless it seeks separate profit against the interest of the company. Furthermore he never used the term "enterprise as such"; it was attributed to him incorrectly.[1]

Public opinion in the nineteen-twenties showed much interest in company law reform. Both economists and lawyers, as well as Bar associations, professors of law, judges and civil servants published many essays and memoranda on the subject. The tendency was in the direction of bringing German closer to American law, and especially of finding new ways and means of attracting capital. The Reich Ministry of Justice prepared a draft for the amendment of the law, but before it could be presented to the Reichstag events gave quite a different turn to the evolution of company law in Germany.

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22. American Business Corporations after the First World War

THE NEW DEAL COMPANY LEGISLATION

One far-reaching economic consequence of the First World War was that the United States became a creditor nation.

[1] Cf. *Weltwirtschaftliches Archiv*, vol. 12, 353; Conrad, *Jahrbuch*, 130.942.

America's debts to Great Britain and France were repaid, and those to other belligerent countries virtually wiped out. Furthermore, European investments in American securities greatly diminished. A considerable part was sold to pay for goods purchased by the countries concerned, and the U.S.A. acquired large balances against the belligerent countries. The further implications of this complete reversal of America's economic position came to light only at a later date.

During the war itself a new factor emerged: the formation of a number of corporations from public funds, as agencies of the Federal Government to further the war effort (cf. § 29).

Another event was the Clayton Act (1915), a further step in anti-trust legislation mainly of interest for its prohibition of interlocking directorships. It proved virtually ineffective.

When the war had ended, the vast liquid assets amassed in the U.S.A. sought profitable placement, for which the creation of new corporate enterprises and the increase of the capital of those already existing naturally provided an ample field. Both the number of corporations and the amount of capital invested in them were constantly on the increase, a process interrupted only for a short time by the slump of 1920. The increased craving of liquid assets for profitable employment created bull markets, which in turn attracted wider circles hitherto perfect strangers to investments in stock. Clever salesmanship enhanced this movement.

It is estimated that in 1922 there were already 14,400,000 individual stockholdings in American corporations, about 3,400,000 of which were acquired in the three years after America's entry into the War.[1] Many of the shares were deprived of voting rights. One artificial silk concern gave voting rights to 2000 out of a total of 600,000 shares. A brewery had 3872 management shares and 180,000 non-voting shares. A theatrical concern issued 100,000 voting and 3,900,000 non-voting shares. In 1925, according to Ripley, the control of $1500 millions of public investment in electric light, power, gas and water companies was vested in 10 per cent. of the capital. Thus, in spite of the wide dispersal of ownership, voting control remained in the hands of a very narrow circle of shareholders. As examples of dispersal we may note that the Pacific Gas and Electric

[1] Carver, *Present Economic Revolution*, 99–107, and Ripley, *Main Street and Wall Street*, 116.

Company had 4128 shareholders in 1914 and 26,294 in 1923; the Southern California Edison 2000 shareholders in 1917 and 65,636 in 1923. Standard Oil and its subsidiaries had 300,000 shareholders in 1925. At the same time there were about one million holders of railway bonds.

Several leading corporations endeavoured to place their shares with their own employees. In 1925 a quarter of the employees of the U.S.A. Steel Corporation held stock thereof to a value exceeding $100 millions. Many employees of the Standard Oil concern held shares in the associated companies.

The sale to customers of shares in electric light and gas companies was typical. The 185 companies reporting to the National Electric Light Association placed shares with 652,900 of their customers in the period 1914–23. Similarly hundreds of thousands of customers held shares in telephone and telegraph companies.

The holding company came to be used not only as a means of industrial concentration, but also as an instrument for controlling big corporations by relatively insignificant investments. The pyramiding of successive holding companies, each acquiring a bare majority of the shares of the next link in the chain, would in itself have proved an effective weapon. Its potentialities were multiplied by an increasing use of the issue of non-voting shares. However conscientious the management, such structures could not but be dangerous. The dangers were increased by interlocking holdings on the part of corporations in the same field, so that hardly anyone was able to ascertain their real position. Such a situation not only enabled, but invited, reckless promoters and managers to sell to the gullible public securities of very little, if any, intrinsic value and to build up pyramids in no way justified by economic considerations. Such structures were doomed to collapse before even slight disturbances, with enormous losses for investors, as happened with the Van Sweringen concern in the railway field, and the Insull concern in that of public utilities.

For the time being, however, there was nothing to stop promoters. The various State laws still favoured and professed full and unfettered company autonomy, and the common law tradition, which gave protection to some extent, was constantly pushed aside. The decisive factor was, of course, competition to attract incorporations. Certain States, chief among them Delaware, further liberalised their corporation laws; their example

was followed by others, and even more conservative States felt compelled to make concessions. Thus no par value shares were adopted by a number of States, and in some cases the Statutes did not restrict companies from using the amounts paid for such shares either as capital or as surplus at their own free choice.

The same attitude could be observed in other directions. In 1929 Delaware departed from the principle that dividends might be paid only out of net profits, provided that such payment did not impair the integrity of the capital. It is no wonder that in 1929 incorporation fees in Delaware amounted to $3,300,694, franchise taxes to $2,270,496, and the revenue from both to $5,511,194, while the total revenue of the State was only $13,109,376. This liberality in the matter of corporation law paid the State handsome dividends. Only a minority of the corporations incorporated in Delaware carried on business in that State. Of the 606 companies whose securities were listed on the New York Stock Exchange in 1931 no less than 209 were Delaware corporations, and only 49 companies incorporated in New York State. Of these 209, 179 held stock in other corporations, 37 being pure holding companies, and 142 operating plants of their own in addition. On the New York Curb Exchange the position was still more favourable to Delaware incorporations: out of 503 securities quoted, 191 were Delaware securities, and only 78 those of New York companies.

A special and by no means creditable part was played during the boom by the investment trusts, which came into vogue only in the third decade of the century. These attracted wide circles, especially of small investors. The capital invested through them was very substantial, amounting in 1931 to about $3,500,000,000. Their investment policy, as was discovered after the collapse, was often negligent, and sometimes not quite honest. It cannot be doubted that the boom was fostered by the large volume of liquid funds in the hands of inexperienced people, and the reckless credit policy of many banks. But it is equally true that the laxity regarding incorporations and the absence of effective regulation contributed greatly to this excessive speculative movement.

The inevitable collapse came in September 1929. It was not recognised for quite a time. Many prominent bankers thought the crisis a mere temporary setback and tried to overcome it by supporting the market. As we shall see (§ 66, Vol. II), this view in

some cases induced corporations to purchase large blocks of their own stocks. But all these steps were illusory. The U.S.A. had to endure the most gigantic crisis of its history, and recovery only set in under the presidency of F. D. Roosevelt. Whether and how far this recovery was due to automatic readjustment or to the "New Deal" policy we have not to investigate. The crisis, however, and the ensuing examinations of its character, especially that made by the Senate Committee (generally called, after its counsel, Mr. Ferdinand Pecora, later Justice of the Supreme Court, the Pecora Committee) brought many disturbing facts and failures to light and undoubtedly influenced legislation.

Congress created a number of corporations from public funds in order to stimulate employment and to promote economic activity in various fields. These measures will be discussed in § 29.

The first legislative measure adopted by Congress was the Federal Securities Act of 1933, amended in 1934 and 1940. This Act extends to a large variety of securities, and we deal with it here only so far as it concerns shares, bonds and debentures issued by business corporations. The Act does not regulate securities issued by National or State banks, nor those issued by one of the Federal Reserve banks or representing interests in them. Even within this restricted scope, securities issued exclusively to persons residing in the State in which the company is incorporated and does its business are excluded, and originally the Federal Trade Commission, later the Securities and Exchange Commission (S.E.C.) was empowered to exempt securities if the total amount of the issue did not exceed $100,000. Intra-State issues are therefore not subject to the Act. At the same time it must be remembered that many, if not most, States have their own Securities Acts, the so-called "blue sky laws".

Again, the Act regulates only issues or public offers; other transactions, i.e. those in which neither of the parties is issuer, underwriter or dealer, or where the transaction does not involve a public offer, are exempt. So also are transactions where an underwriter or dealer does not act in that express capacity, unless they take place within a year of the original issue.

The Act requires that before securities subject thereto are publicly offered or dealt in, issues shall be registered with the Commission. For this purpose a statement must be signed by the principal executive and the majority of the board of directors of the issuing body. The form and contents of the documents

required are enumerated in a schedule, and accountants, engineers, appraisers and valuers who give information, or are named as such in the statement, must sign a statement or document, or if the document was not prepared for use in connection with registration, must give their assent to its use. The information to be given as set out in schedule A includes all relevant particulars relating to the corporation. We shall discuss these particulars in connection with public offers of shares and debentures (§§ 44 and 46). For the moment we need only note that any interest in the issue or in the capital of the corporation exceeding 10 per cent., and likewise options affecting a similar proportion, are to be disclosed. The remuneration of directors, officers and other such persons, must be declared. If this has exceeded $25,000 during the past year or will do so during the ensuing year, the persons receiving it are to be named. The term for which earlier transactions relating to assets and material contracts are to be disclosed covers the two years previous to the issue. The balance sheet must be of a date not more than ninety days before the filing of the statement.

Besides the numerous particulars required by the Act and Schedule, the Commission has power to require further information and documents. It is furthermore empowered to make examinations and is to have access to the books and papers of the corporation. It may also examine witnesses under oath by officers delegated for that purpose. *Inter alia* the Commission may require the production of the balance sheet and income statements, i.e. profit and loss accounts. It may refuse registration if not satisfied with the information submitted. In the case of refusal, or if additional information is required, the parties concerned may request a judicial review of the Commission's decision by the Circuit Court. Previous to such request, however, the objection must be raised before the Commission. The Commission's findings are conclusive evidence, but the Court may grant leave to produce additional evidence, and may order stay of the ruling during the proceedings.

The Commission may also classify prospectuses according to the nature and circumstances of their use, and may issue rules and regulations both as to their form and contents in the public interest and for the protection of investors. Even radio broadcasts used in the interest of the issue shall be filed with the Commission, if it so prescribe.

In the absence of registration it is unlawful, under penalty, to make use of any means or instruments of inter-State transport or commerce, including the mails, for sales or offers for purchase, or to forward securities for delivery, or for distributing prospectuses and other offers for sale.

The Act establishes liability for untrue statements or omission of material facts. All those facts are material which are necessary to make the statement not misleading. Omission of a fact is always ground for liability if the statement of such fact is required by the Act itself or by an Order of the Commission. Liability extends to all persons who signed the document, the directors of the corporation making the issue, and all persons named as directors or prospective directors, accountants, engineers, etc., who made or authorised the statement. Any such person can exculpate himself only by proving that he has resigned previous to the issue or had no knowledge that he was named in the statement, and that he took immediate steps to disclaim responsibility for it. Such persons may base a defence on proof that they had reasonable ground to believe the statement true, or in the case of the reproduction of a statement made by another person, that they had no reason to believe it untrue. The test of reasonableness is what a prudent man would require in managing his own property. In the case of untrue statements the liability also extends to exempt securities and transactions.

The measure of damages is the difference between the price at which the security was offered, and that at which it was or could be sold, unless the depreciation was due to other factors than the false statement. Any purchaser of the security is entitled to sue for damages. Those, however, who purchased the security after the issue of the first balance sheet of the corporation concerned can sue only on proving that they did so in reliance on the untrue statement. It is obviously difficult to produce such evidence, and the Act alleviated the purchaser's position by laying it down that a purchaser has not to prove that he had read the statement before the purchase. Action is to be brought within one year after the detection of falsity and within three years from the offer. All persons liable are joint and several debtors of the purchaser, and every person compelled to pay under the Act has recourse against other persons liable. An important provision is that no one can contract out of the liability, and all contracts purporting to exclude or restrict liability are void. Persons who

control the acts of liable persons are themselves liable. All remedies granted by the Act are additional.

As we have already mentioned, the Commission's powers were very wide; all hearings before it were to be public. Originally it was the Federal Trade Commission to which their exercise was entrusted.

The next step was the Securities Exchange Act of 6 June 1934. This Act established the Securities Exchange Commission to regulate and supervise the working of the National Securities Exchanges, and entrusted it with all powers given to the Federal Trade Commission under the Securities Act of 1933. This Commission consists of five members appointed by the President with the advice and consent of the Senate, for a term of five years. Not more than three members may belong to any one political party. The provisions of the Act relate firstly to dealings in securities on the National Stock Exchanges, but beside these and some amendments to the Federal Securities Act, it contains others which are important for corporation law in so far as it deals with corporations which have issued securities which are dealt in at one of the National Securities Exchanges.

It is made unlawful to use inter-State communications for the transaction of business in securities not registered in one of the National Security Exchanges, unless they have been specially exempted from this restriction. The Securities Exchanges must themselves apply for registration to the S.E.C., which will grant it, provided they comply with the provisions of the Act and the regulations and requirements made thereunder by the S.E.C.

The Act regulates the maximum margin for the purchase of securities, which the Commission may increase or reduce at its discretion. In order to prevent manipulation of prices, transactions by which beneficial ownership of securities is not altered are prohibited, this prohibition extending to matched prices and sale orders if similar purchase orders are given at the same time with the knowledge of the members, brokers or dealers concerned. Untrue statements made in order to induce sales or purchases, and all other similar manipulations and untrue or deceptive communications, are likewise prohibited.

The functions of members of the exchanges, brokers and dealers may be segregated and limited by the Commission.

The requirements to be complied with for listing securities are similar to those prescribed by the Federal Securities Act for

registration and for prospectuses. Whereas the requirements of the Federal Securities Act have to be complied with at the time of issue of the securities, corporations which wish to have their securities listed on one of the National Exchanges must comply constantly with those requirements, and especially must publish annual reports and file them with the Stock Exchange and with the S.E.C., and must also submit such statements as the S.E.C. may from time to time require. We may therefore repeat at least the main requirements. The corporations concerned must give particulars as to their organisation, their various issues and the rights granted to each of them, the terms of issues offered during the last three years, the holdings of directors and officers and of every beneficial holder whose holdings exceed 10 per cent. of each category, the remuneration granted to directors and officers, and to all persons whose remuneration exceeds $25,000, and all bonus and profit-sharing agreements. The balance sheets and the profit and loss accounts for the last three years must also be submitted, and, if the Commission so require, certified by independent accountants.

Since the S.E.C. may, and in fact does, require the submission of annual returns, and can prescribe their form and contents, many questions which under other legislations are regulated by Companies Laws are in the U.S.A. entrusted to its discretion. Its powers extend *inter alia* to the regulation of all material questions of accounting, e.g. valuation and depreciation, and it may even prescribe the drawing-up of consolidated accounts.

The solicitation of proxies may be regulated by the Commission, and it is unlawful to use inter-State mails for solicitations not complying with its regulations; nor are members, brokers and dealers permitted to give proxies in violation of them.

Corporations must disclose the holdings of directors, officers and all persons who own beneficially 10 per cent. or more of stock and all so-called equities in general. This statement is to be filed with the Exchange and a copy thereof with the Commission, and any changes in the ownership of such holdings are to be reported monthly. Furthermore directors and officers are not entitled to retain profits made by purchase and sale of equity securities within six months of their purchase. Such profits are to be disclosed and may be recovered by the corporation.

Although the Act is intended to prohibit short selling in general, since such selling may artificially influence prices, in the

case of directors and officers this prohibition is expressly stated. It is specially provided that they may not sell equities which they do not own at the time of sale or do not deliver within 20 days, or post within five days after the sale. The rules as to liability in case of violation of these provisions are the same as under the Federal Securities Act. For any misleading statement liability is imposed. All liability under the Act extends to persons controlling those who committed the violation.

The Commission's wide powers of requiring information and ordering investigations are somewhat limited by the provision that parties may object to the publication of their statements. Similarly it is provided that hearings before the Commission need not be in public if it so thinks fit. The possibility of judicial review is undoubtedly a safeguard for all parties concerned.

The penalties under the Act are stricter than in the case of the Federal Securities Act: fines up to $10,000 or imprisonment up to two years, or both, may be imposed.

The abuses detected during the aftermath of the great crash were especially obvious in the case of public utility holding companies. Their worst feature was the building-up of systems with, in some cases, total disregard of geographical considerations, and the domination of such systems by quite insignificant minorities. The instruments used for this purpose were holding companies and their pyramidal organisation. In addition, large blocks of shares were disfranchised. Shareholders were unable to ascertain the real value behind their shares or the profits due to the company in which they were interested. Managers had wide facilities for transferring profits from one company of the group to another, in the interest of manipulations aimed at influencing market prices. The consumer or even the public authorities could not control the prices charged by an operating member of the group of companies controlled by the ultimate holding company. Federal legislation was therefore directed to the subject of public utility holding companies, and the third step was taken in 1935 by the passing of a special Act dealing with them.

The aim of this Act was to protect investors, consumers and the public against abusive practices in corporate finance and management. In view of this the issue of securities by public utility holding companies was made dependent upon the permission of the S.E.C. The simplification of the structure of all public utility companies was declared an eventual aim. We

shall see, however, that this aim could be reached only gradually, in consequence of the restricted powers of the Commission.

Speaking generally, Federal legislation does not pretend to reach companies which are registered and operate only in one single State. With regard to these, State legislation and State authorities, especially Commissions, normally retained their competence. Therefore the issue of securities merely for one enterprise registered and operating in the same State was not affected, provided the issue was to serve the needs of the company only, but even in such cases the S.E.C. could impose terms and conditions in the public interest or to protect investors and consumers.

The Act strongly denounced well-known abuses in the field of public utility holding companies, firstly, the impossibility of procuring adequate information, which was due mainly to the absence of a common standard form of accounts and was aggravated by the malpractice of inter-company transactions, resulting in paper profits and their distribution as dividends. Furthermore securities were issued without the approval of the competent State authorities on the basis of fictitious or unsound asset values, or in anticipation of future resources. In consequence most of the companies were over-capitalised. Excessive charges were often accounted for services, and accounts were artificially complicated in order to obstruct State control. There was a lack of economy in management, and on the whole the entire structure of holding companies showed an unhealthy overgrowth.

In order to end these and similar abuses, the Act provided for putting the electricity and gas holding companies under the control of the S.E.C. The companies covered by the Act are those occupied in the production, transmission or distribution of electric or gas light and power.

Holding companies were defined as those which control 10 per cent. or more of the securities with voting power of another public utility company, being either an operating or a holding company. Conversely a subsidiary is a company 10 per cent. or more of whose securities entitling to votes are the property of another company. The Act recognises another category of companies, namely affiliate companies, where the limit of voting securities is 5 per cent. The S.E.C., however, may declare that a company is not a holding or subsidiary company and may

grant exemptions to such companies. The S.E.C. may also grant exemptions on the ground that the holding company is an intra-State corporation, i.e. that it operates only within one State, or further on the ground that it is only incidentally a holding company, or does not derive any substantial part of its profits from such enterprise or assets.

Companies falling within the competence of the S.E.C. had to register with the Commission by 1 October 1935, and might not operate, distribute, transport or sell electricity or gas after 1 December 1935 in the absence of registration.

In order to obtain registration detailed information was to be given to the Commission on the organisation and financial structure of the corporation. Of these requirements the most important are that balance sheets and profit and loss accounts for five preceding years must be produced, that interests and remunerations of directors must be disclosed, as well as all bonus and profit-sharing arrangements and options existing in respect of securities. The S.E.C. was empowered to demand further information, but might grant the corporation interim registration and dispense at its discretion for the time being with further information.

The corporate life and activities of the corporations concerned were subject to the control of the S.E.C. In particular, any issue of securities was made to depend on the Commission's consent, without which it became unlawful to sell or to offer securities. To obtain this the corporation must file a declaration, and the Commission was empowered to examine the transaction, demand information, and supervise the conditions and terms of the issue.

The Act further defined the ideal type of financial structure: shares (stock) should be issued with a par value without preferences either in dividends or in "distribution over" (i.e. in case of winding up), with equal voting rights, and, where shares have already been issued, with voting rights at least equal to those of the already existing shares. Bonds should give first lien upon all or part of the real property of the corporation, or some similar asset of the subsidiary. The Commission, however, might dispense with these provisions, and in fact this power has been exercised with moderation and the ideal requirements have not been dogmatically enforced.

It is unlawful for a corporation registered and working in a State to acquire assets of or interest in utility companies in violation of that State's law.

Neither holding nor subsidiary companies may acquire assets or securities of public utility corporations without the Commission's approval. Inter-company borrowings and lendings, inter-company acquisitions, payment of dividends, and the conclusion of service contracts are subject to the Commission's approval.

The Commission may require periodical and special reports and fix their contents and form.

The accounts of public utility holding companies are subject to the rules and requirements of the Commission, which also has power to examine them. Liability for misleading statements is the same as under the Act of 1934. The duty to disclose interests on the part of directors and officers, and any change in such interests, the obligation to surrender to the company profits from purchase and sale transactions within a period of six months, remain under the same rules as before.

In the event of any reorganisation under the supervision of the Court, the Commission has direct power to prescribe its conditions. If a receiver or trustee is to be appointed, the Courts are to appoint the Commission as receiver or trustee, provided it is willing to undertake this function. No other receiver or trustee should be appointed without its assent. In the case of voluntary reorganisations the Commission's power is only indirect in that no issue is to be made without its assent.

The Commission has full power of investigation. In case of need its orders are to be enforced by the Courts. The method of hearings and the records to the Courts are under the same rules as provided by the Act of 1934. The Commission is to submit a yearly report to Congress.

In considering the practical work of the S.E.C. in respect of new issues, we must remember that most of the issues since its formation were refunding or exchange operations, and few were floated for other purposes. Furthermore it had power to grant exemptions if the requirements would impose unreasonable financial burdens upon the company, or were not necessary for the protection of investors, consumers and the public. A competent authority connected with the Commission has stated that the main reasons for refusal are that the issue is not necessary for the company's regular business, or not adequate to its structure, or that the fees, commissions or other remunerations are not reasonable. In cases where the applicant would undertake a

guarantee, the Commission may refuse the permit if the guarantee would involve the company in improper risks.

The Commission, in accordance with the general principle of sec. 7, c. 1 of the Act, has to look with disfavour on issues with no, or a low, par value. Nevertheless these were permitted in special circumstances, as when such an issue was in the interest of all concerned, the transaction would have been impossible or difficult on the basis of par value stock, and the whole consideration was appropriated to the capital account and not the surplus.[1]

The position as to voting power was similar. The Commission has not enforced alteration of the articles in cases of reconstruction. In other cases it had no power to do so. It has, however, been declared that preferred shares should carry voting rights, and that where there is default in payment of dividends, voting power should be made effective. In cases where ordinary shares of low or no par value would outnumber the preference shares, separate safeguards are desirable. Nevertheless in one case (American Waterworks and Electricity Company) such alteration was not required in view of the company's good record with regard to dividends.

Voting trusts have been allowed by the S.E.C. where they were found likely to secure stability in management.[2] In both cases the voting trusts were compelled to register as holding companies under supervision of the Commission. On the other hand the term of the trusts was reduced.

The Commission declared itself against depriving shareholders of pre-emptive rights in the case of issues for cash, but allowed this in the case of the National Gas and Electricity Company, where the shares were issued for property. In this case 78 per cent. of the voting certificates were in favour of the issue and the remaining 22 per cent. did not dissent.

Under sec. 11 (*b*), the S.E.C. was empowered to provide for simplification both in order to form geographically integrated public utility systems and also to simplify the internal structure of the combines. In the latter respect the purpose as laid down by the Act is to obtain a fair and reasonable distribution of voting power. It was, however, provided that the S.E.C. was not to

[1] National Gas and Electric Corporation, release 768.

[2] Lakes Utility Company, release 595, and American Telephone and Electric Company, release 1187.

exercise this power before 1 January 1938. The validity of this provision was only settled by the Supreme Court in February 1938 in Electric Bond and Share *v.* S.E.C.[1]

Up to the end of 1938 the S.E.C. exercised this power in a cautious and moderate manner. Corporations were permitted to submit voluntary plans until 1 December of that year. In particular cases, too, the decisions of the S.E.C. were considerate. Thus in the case of American Waterworks and Electric Company,[2] the top holding company was in one direction of the fourth, and in another of the 5th degree. Under the decision of S.E.C. there remained three grades under the top holding company. Of these three were both holding and operating corporations, several others merely operating companies.

In the West Pennsylvania Power Company case,[3] the S.E.C. decided that this corporation was not a subsidiary of the West Pennsylvania Railway Company, although the latter company owned 31 per cent. of the shares of the former. It was held that since the remaining 69 per cent. of the West Pennsylvania Power shares were held by American Water and Power Company, the West Pennsylvania Railway Co. was not in control, but had only a controlling influence.

The Commission declared itself strongly against abuses in underwriting and the exploitation of companies by unfair underwriting agreements and disproportionate commissions. Such abuses were widespread; they occurred in many cases merely in actual practice without any legal instrumentality, while in others separate corporate entities were used for underwriting and in others underwriting firms were represented on the boards. In the Commission's opinion underwriting should be done on the basis of competitive bidding, and conflicting interests should not be represented on the boards or finance committees of the issuer. Nevertheless the Commission did not draw the ultimate consequences from this principle. Thus in the Kansas Electric Power case,[4] the issue of first mortgage bonds was approved in spite of the representation of conflicting interests on the finance committee of the subsidiary which financed the transaction, since the spread of 2½ per cent. exceeded only by ¼ per cent. the commissions paid for comparable issues known to the S.E.C. Furthermore the Commission did not prescribe competitive bidding as compulsory; it merely reserved the right to investigate the

[1] 303, U.S. 419. [2] Rel. 949. [3] Rel. 953. [4] Rel. 486.

remuneration paid in the absence of competition, and where the spread was adequate, the issue was approved. In another case the Commission approved the issue by a majority decision on the ground that otherwise a new negotiation of the loan would be necessary to the detriment of the contract.

In reconstructions, the S.E.C. was granted express and direct power only under the supervision of the Court; but secs. 6–7 and 11 (*g*) gave indirect powers which amounted to the same thing. A plan is to be submitted with disclosure of the applicant's interests in the securities concerned, each class of security holders being represented independently. Security holders should be fully informed, the plan should conform with S.E.C. standards. On the other hand, persons soliciting proxies or acceptances are to be placed under fiduciary responsibility, whether they act as a committee or otherwise. Persons who submit plans for reconstruction should have a *bona fide* interest in the plan. In practically no case, however, were plans rejected for lack of such interest.

Under sec. 10 of the Bankruptcy Act, an independent trustee is to be appointed in every case involving more than $250,000. The Commission insists upon the representation of each issue by a separate trustee, although it has actually approved in at least one case an issue in which the same bank acted for two issues, and in this case granted exemption.[1]

It is interesting to note that the S.E.C. holds earning power to be the proper basis of valuation. On the other hand it has declared itself against writings-up, whereas the consideration of reproduction (replacement) value has been rejected.[2]

The requirement of full information tends in practice to be excessive, and it has been observed that too much information does not promote the participation of security holders in general meetings. The S.E.C. makes the giving of full and perhaps exaggerated protection to existing priority rights its duty, but this principle may in some cases lead to a deadlock.

With regard to solicitation of proxies the Commission has decided that a protecting committee was not qualified to act as proxy, since it required too extensive powers ("blank cheque"); furthermore the withdrawal of depositors was made difficult, and the protective committee reserved for itself power to deal in deposit certificates and in the securities of the corporation. In

[1] Indiana General Service Company case, rel. 1261.
[2] Genesee Valley Gas Co., rel. 981, and Ohio Gas Co., rel. 1284.

the same case the members of the committee stipulated for exemption from liability, except for gross negligence and wilful default.[1] In one case of conflicting interest where the trustee was the largest single shareholder the S.E.C. approved the transaction by a majority vote merely for convenience.[2]

It may be assumed that after a fairly long period of control the Commission will succeed in simplifying the whole public utility system, and it is to be hoped that it will be more energetic in practice in attaining its purposes without losing the necessary elasticity.[3]

The Public Utility Holdings Act of 1935 provided for an intensive study of investment companies. The results were published in 1939 and a Bill was presented to Congress, which became law on 22 August 1940. According to its preamble investment companies are of national importance because their securities are widely dealt in as part of inter-State commerce, and in the case of companies with redeemable securities the dealings are continuous, the transactions in such securities are conducted through the mails and other means of inter-State communication, they concern a large part of the national savings, and lastly effective supervision by State regulations is difficult if not impossible. Therefore the national interest is affected and that of investors endangered by incorrect information, by absence of adequate and explicit accounts, and by the management of investment companies in the interest not of the investors but of directors, officers, depositors, underwriters, brokers, dealers or investment advisers. The same applies if the management promotes the interests of special classes of security holders. Inequitable or discriminating provisions in the terms and conditions of securities are equally damaging, and the failure to protect investors has proved to be of disadvantage. Lastly pyramiding and inequitable methods of control are other abuses against which the Act is intended to give protection (sec. 1).

The method of protection provided is to place all investment companies under the control of the S.E.C. By sec. 3 companies primarily engaged in investing, re-investing or trading in securities, or in issuing face value certificates, and those which own or propose to acquire securities having a value of 40 per cent. or

[1] John A. Dawson, Utility Power and Light Corpn., rel. 1200.
[2] Kansas Power Co., rel. 486.
[3] John F. Meck and William L. Cary, 52 H.L.R., 216/258.

more of the issuer's total assets, belong to this category. Investment companies are compelled to register with the S.E.C. (sec. 8), and unregistered companies are prohibited from selling or offering securities in inter-State commerce (sec. 7). No company is to be registered without net assets exceeding $100,000. At least 40 per cent. of the directors must not be executives, and the majority of the board shall consist of persons who are not investment advisers, investment bankers, brokers, etc. For registration a time limit of one year is given. No investment company may issue so-called senior securities (bonds) which are not covered at least by assets worth 300 per cent. of the bonds, or preference shares (stock) not covered by at least 200 per cent. The powers of the Commission are the same as those already set forth in connection with the preceding Federal Acts of 1934 and 1935.

In addition to the regulation of investment companies, the activities of investment advisers were also dealt with. The Act laid down strict requirements as to personal qualifications, to securing the honesty and reliability of persons engaged in investment advising. Advisers must be registered. They may not stipulate for compensation on the basis of capital gains or capital appreciation. Nothing is more apt to induce persons to reckless speculation than contracting for compensation on this and similar bases, and the Act had ample reason to prohibit canvassing on this basis.

The foregoing roughly summarises the content of New Deal Company legislation, apart from one highly technical matter, that of trust indentures, regulated by an Act of 1939.

If we take into account that from another point of view railway companies are also subject to regulation by Federal Acts and that larger corporations generally speaking have securities on the lists of at least one of the National Exchanges, it may be stated that most larger corporations are regulated to some extent in one way or another by Federal law. At the same time even those corporations which are subject to one of these Acts are regulated in other respects by State legislation. On the other hand an immense number of corporations, especially the smaller ones, are in no way affected by Federal legislation, and thus the work of unification has made but little progress.

Turning now to the working of Federal legislation, it is obvious that Congress has provided only to a limited extent for regulation by law, and that its method of procedure has been rather the establishment of a department with wide administrative

powers. This central body the S.E.C., with its eight regional officers and more than 1200 employees, will surely find its way by continual experience, by trial and error. The danger, however, remains that its work may result in a cast-iron bureaucratic machinery with all the well-known drawbacks inherited from the past: slowness, uncertainty as to rules, and inconsistency in their application.

The need for further extension of Federal legislation has not been overlooked. An approach in the direction of requiring a Federal licence for all corporations was made by the introduction of the O'Mahoney-Borah Bill, which, however, was not proceeded with. Later Senator Joseph O'Mahoney introduced on 6 January 1945 a new Bill relating to both corporations and trade associations. Here we are concerned only with its contents so far as they relate to the former.

After one year from the coming into force of the Bill every corporation engaged in commerce is to be compelled to obtain from a Federal commission, the name and constitution of which is left unsettled, a certificate of statutory compliance. Should a corporation commence business without such certificate, it shall be subject to a fine. For the first month this fine is very moderate, $25 for the first 30 days, but for every subsequent month it is 1 per cent. of the book value of the capital stock of the company. It is to be recoverable in favour of the U.S. by way of a civil action.

In order to obtain the certificate the corporation must file with the Commission a certified copy of the document which is the basis of incorporation, i.e. the charter, articles, certificate of incorporation, etc., as the case may be. The issue of a certificate of compliance may be refused if this basic document does not comply with certain fairly comprehensive requirements. The corporation shall be prohibited from having as a director any person who is a director or employee of any competing corporation or anyone who is in business relations with such a corporation. Financial interest in any enterprise falling under the same category is likewise prohibited. Directors must have an actual and *bona fide* interest in the corporation which they are serving.

At least once a month a meeting of the board of directors is to be held and they are to be informed at frequent intervals of the corporation's operations. Full and complete transcripts of all meetings of the board of directors and of any committee thereof are to be kept.

The corporation is to provide for reasonable compensation of directors. A written report is to be made yearly, completely disclosing all transactions between directors and the corporation throughout the year, and any dealings by directors in the stock or other securities of the corporation. This report is to be mailed to all recorded shareholders.

There are special requirements as to dealings with foreign nationals and corporations, whether general plans or programmes, or individual contracts and arrangements to effect transfers of property, franchises or other rights, including patents, to or from such persons.

The charter is to provide that directors shall be deemed to be trustees for the stockholders and be bound to apply in the performance of their duties the care employed by a trustee in the administration of a business with which he is familiar. Provision is to be made that any director who fails to attend meetings of the board over a six months' period forfeits his directorship.

Every director shall be made individually liable to the corporation for damage caused to the corporate estate by the violation of Federal law through any act done, ordered or authorised by him. Reimbursement to directors or officers of any expense sustained or incurred as a result of such violation is prohibited.

Each share shall give a vote in all matters which are determined by the vote of stockholders. Any proposal by directors for altering the existing rights of members (stockholders) or their securities shall be fully disclosed to them within a reasonable time before their consent is sought to such proposal. If the proposal concerns an alteration of the existing rights of any class of stock or security holders, it is to be submitted to them and cannot be made effective until approved.

Full disclosure is to be made of any voluntary payments made by the corporation.

A provision is required prohibiting the direct or indirect purchase of stock or other interest in corporations whose principal business is other than that of the buyers.

Should the issue of the certificate be refused, a corporation which has filed its charter may file a petition to compel the Commission to make the issue within 60 days. For this purpose competence lies in any District Court of the U.S.A. in the district where the applicant has his office or does business, or alternatively

in the District Court for the District of Columbia. There is an appeal from the decision as in ordinary civil actions.

In case of violation of the Act the U.S.A. may bring suit to enjoin (prevent) or restrain the corporation from further violations and also to restore its condition as nearly as possible to what it would have been without the violation. The U.S.A. may also bring action for revocation of the certificate in case of wilful, knowing or repeated violation of its provisions.

Where the corporation is liable for civil penalties as aforesaid on the ground that it has engaged in commerce without the certificate of statutory compliance it may recover the amounts paid from the directors, officers or other persons responsible for such violation. Such persons are liable jointly with the corporation for the penalties, and may be joined as defendants in the action.

Incomplete as this Bill is, its adoption would be an important step towards the establishment of a Federal Corporation Law. It is however hardly probable that the constitutional objections to the impairment of State sovereignty can be overcome, though the Final Report of the Temporary National Economic Committee recommended the adoption of a national charter law.

There is a strong movement in favour of attaining the unification of the corporation laws by laying down universal rules to be adopted by all State legislations. The Commissioners on Uniform State Law published in 1928 a draft Uniform Business Corporation Act, which was virtually adopted by Louisiana, Idaho and Washington. Moreover the corporation laws of several States, enacted since 1929, were largely influenced by this draft. The American Law Institute began work on a restatement of the law of business associations, but up to 1932 only three partial tentative drafts have been published, covering only a small sector of corporation law, and there seems to be no intention to continue the work.

The latest attempt is that of the American Bar Association. Its Corporation Law Committee in October 1946 completed a draft of a Model Business Corporation Act, consisting of 145 sections. This draft omits the matters covered by the securities and blue sky laws, and is merely an enabling Act. Its adoption by the State legislatures would be of great importance.

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23. German Companies in and after the Crisis. Nazi Company Legislation

The New York stock market collapse shook Germany's economic life to its foundations. German securities placed abroad, State, communal and other bonds, and corporate bonds and shares came on the market in huge quantities and were dumped into Germany, where the issuing houses had somehow to take them up. At the same time an immense amount of short-term loans was called in. This enhanced selling, but there were few buyers.

German companies felt they must stem the tide, and acquired large blocks of their own shares. The position of banks thus became very serious, and the Government had to intervene by granting moratoria, and to acquire bank and industrial shares in large amounts from public funds in order to avert insolvencies. In these circumstances it was felt that urgent reforms were needed, and that the normal course of legislative machinery was not sufficiently rapid to effect them.

By an emergency Order of 19 September 1931 the Reich Government introduced such reforms as it was felt did not admit of delay. Many of the provisions of this Order, which formed a very curious medley, found their way into the German Companies Law of 1937.

The most urgent need was for the regulation of purchases by companies of their own shares. As we saw earlier, the law of 1884 and the Commercial Code of 1897 left many loopholes in this regard, and German companies did not comply strictly with

the prohibition. It was their regular practice to regulate the market prices of their shares, and to sell and purchase them as the Exchange position required. This was done by forming syndicates, mostly financed by the company itself, by making use of subsidiary and associate companies, and other like devices. As long as fluctuations were not excessive, the position of the companies was not greatly affected. But from the end of 1929 the situation became more serious, and many companies held large blocks of their own shares without any prospect of placing them (see § 66, Vol. II). The new Order provided that companies may purchase their own shares in order to prevent serious impairment or grave damage, but that such purchases may not exceed 10 per cent. of their capital. At the same time reductions of capital by cancellation of such shares, and in other ways, were eased for a short transitory term, until 1 July 1932. Thereafter the normal methods of capital reduction were to be adhered to.

Among other modifications of the law, the granting of credits to managers was made to depend upon the board of supervision. This provision was undoubtedly an improvement on the custom of managers granting loans to each other, but it was a sign of the general trend of opinion that the assent not of the general meeting, but of the board, was required.

The maximum membership of this board was fixed at 30. It was further provided that no one may hold more than 20 mandates on such boards. The period of office of the boards is to terminate at the following general meeting, and the provisions of articles dealing with boards of supervision and their remuneration are to be cancelled. General meetings are also empowered to enact new provisions by a simple majority, instead of the three-fourths majority hitherto required. Any member of the board of supervision may request the chairman to convene a meeting, and two members may themselves call such a meeting, should the chairman not comply with their request. Any abuse of this power is to involve liability for damages.

The contents of reports to general meetings are to be specified and are to give full information, unless the interests of the company or of any subsidiary or associate company otherwise require.

Detailed provisions were laid down as regards the drawing up of balance sheets and profit and loss accounts. Both must be clear and informative as to the company's position. Any obligations which may arise from guarantees, suretyships or endorsements

are to be included among the liabilities, even though they should not have matured at the date of the balance sheet.

The provisions as to details in the accounts were carefully drafted, and were fitted to secure a full picture of the company's financial position. At the same time the Government by order might lay down forms for balance sheets and profit and loss accounts, in which case the companies concerned must comply with such special Order and not with the general law. The decision whether consolidated balance sheets were to be drawn up or not was likewise left to the Government's discretion.

The Order introduced compulsory audits by qualified accountants. A characteristic provision was that joint-stock companies created specially for audits might do the auditing, provided they include qualified auditors in their management. Auditors are elected yearly by the general meeting; the election, however, may take place at any time before the end of the company's financial year. The members of the management, or of the board of supervision, may object to the persons elected as auditors. Shareholders owning one-tenth of the share capital have a like right, provided they were in possession of their shares at least three months previous to the general meeting. The Court is to decide on such objections.

Auditors are to have access to the books and records of the company and may request information from the board of management. They have to report to the board of supervision, and if they have no objection to the balance sheet or the profit and loss account, they are to endorse them with a signed declaration stating that the company's books, accounts and reports comply with the law. The board of supervision is to inform the general meeting only that the auditors did or did not have any objections to the accounts or reports.

The auditors' examination is not only to compare the accounts with the books and records, but should also ascertain whether legal requirements as to the balance sheet and profit and loss account have been met. The auditors have to perform their duty conscientiously, and are liable in damages to the company should they fail to do so. In case of negligence the damages are not to exceed M100,000 for any balance sheet and account, whatever the number of auditors employed.

Investigation was made easier. General meetings can call for an investigation of promotions and management by a simple

majority. Shareholders representing 10 per cent. of the share capital may demand investigation of promotions and management, but of the latter only for the last two years, provided they held their shares three months previous to the general meeting, and can make out a *prima facie* case. They may likewise request the appointment of other auditors. They are, however, liable for damages caused by malicious and negligent requests, and must give security for such damages if there is plausible reason for so doing. The auditors entrusted with the investigation are to present their report to the management and to the Court, and it is to be placed on the agenda of the general meeting, which is to resolve whether action should be taken against any persons involved.

The right of shareholders representing at least 10 per cent. of the capital to bring a representative action in such a case is maintained, and it was newly enacted that if the report shows facts proving abuses and liability therefor, 5 per cent. of the share capital should confer a right of action. Such an action is to be begun within three months of the general meeting.

Obviously this emergency legislation was not enough to cope with the situation. As a matter of fact many companies already had more than 10 per cent. of their capital in their own portfolios (see § 66, Vol. II), and thus the limitation was of no avail. A large section of opinion both economic and legal, however, regarded the reforms, in so far as they were aimed at securing minority rights, as too wide, while an unbiased critic could not but consider them quite insufficient. The doctrine of the "enterprise as such", and the theory that the interest of the company should prevail, was so strongly rooted in German legal and economic minds as to obscure the whole issue. In any case, the period between the issue of the Order and the assumption of power by the Nazis in January 1933 was too short to give decisive proof whether German corporate life could be rendered sound under this legislation.

The Nazi government began by following the lines of the Order of 1931, but it soon provided for the compulsory limitation of dividends. A law of 4 December 1934 provided that companies might not pay dividends in excess of 6 per cent., or if higher dividends had been paid for the preceding financial year, then not in excess of 8 per cent. of the share capital. The excess of profit over dividends was to be paid into a loan fund which had been established by a law of 29 March of the same year: in other

words, to be invested in Reich bonds. The amounts in question were to be transferred to the Deutsche Gold Diskonto Bank, a subsidiary of the Reichsbank, and not to be distributed, unless this should be allowed by a later law. This measure was mainly a financial one intended to secure additional funds for needs of the Reich Government and other public bodies. In other respects the Nazis favoured large companies and gave generous help to banks and industrial enterprises through the Reichsbank, the Reichs-Kreditgesellschaft and other public and semi-public financial bodies.

From 1934 onwards re-armament began to give a strong stimulus to industrial life, and in other circumstances it should have operated to brighten the outlook of German corporations. But the upheaval was too great, and the racial laws, involving the elimination of many leading figures from banks, trading and industrial companies, and the dispossession of a certain part of the investing public, as well as growing uneasiness about Germany's home and foreign policy, were factors which prevented any improvement.

It is generally assumed that the financial recovery which in 1936–7 was conspicuous throughout the world, and especially in the U.S.A. and Great Britain, was advantageous for Germany also. We cannot examine this question here, but at least with regard to German companies, no such improvement was observable. Both in numbers and in capital there was a steady if slow decline up to 31 December 1937, the last date for which comprehensive data were available to the author.

At the end of 1931 there were 10,437 companies in Germany with a capital of M24,653,443,000. At the end of 1937 the number was 6,094, with a capital of M18,704,506,000. The movement is shown by the following table.

Year	*New Companies*	*Capital of new Companies*	*Increases of Capital*	*Decline in Numbers*	*Net Increase or Decrease of Capital (Marks)*
1930	268	559,681,000	754,298,000	− 374	− 460,650,000
1931	188	543,478,000	818,808,000	− 533	− 464,766,000
1932	80	93,396,000	232,934,000	− 803	−2,389,540,000
1933	95	298,710,000	592,837,000	− 486	−1,628,661,000
1934	61	212,871,000	241,073,000	− 530	− 844,755,000
1935	40	85,451,000	271,146,000	− 778	− 234,297,000
1936	37	136,225,000	595,741,000	− 636	− 331,598,000
1937	24	163,430,000	412,178,000	−1110	− 520,082,000

Company profits, according to the *Statistical Yearbook*, reckoned as a percentage of the capital invested were as follows:

1929–30	4·81
1930–31	4·19
1931–32	–8·71
1932–33	–2·68
1933–34	–0·10
1934–35	3·54
1935–36	4·27
1936–37	4·80

Some companies of course showed profits and paid dividends even in the worst years. The percentages given above show the average profit rate of companies in comparison with their aggregate invested capital. The published results for a restricted number of large companies, representing, however, the bulk of capital investment, show some increase in reserves, but from 1935–6 these appear under two headings: *Reserven* and *Rücklagen*, the latter obviously meaning capital appreciations not distributable, while in respect of reserves proper there is no increase at all.

From 1933–4 onwards current assets are no longer shown as a separate item, and therefore no comparison of short-term debts and current assets is possible. It is true that so far as foreign debts are concerned the distinction lost much of its importance, since their payment was greatly restricted by currency legislation.

We have no exact knowledge as to the extent to which German companies held their own shares in this period. There must, however, have been many cases in which such holdings exceeded 10 per cent. The five leading banks are known to have held from 33 to 65 per cent. of their own capital, and one mortgage bank in 1931 held 20 per cent., i.e. 9 millions out of 45, whereas its balance sheet for 1933 shows a holding of 11 millions, i.e. nearly 25 per cent. of the capital.

Not only did the legislature do nothing against this abuse, but the Government, instead of enforcing the Order of 1931, in 1936 empowered the Ministry of Justice to grant exemptions from the rule. A certain portion of Government holdings in company shares was sold, though in some cases at a considerable loss to the Government and with corresponding gain to the companies concerned, or to their leaders. Nevertheless Government holdings remained substantial, and were even increased by the creation of semi-public mixed corporations.

Throughout the whole period work on a systematic reform of

company law was continued, after 1933 mainly in the direction of introducing Nazi ideology, especially the *Führer-prinzip*. The strongest upholders of this movement, apart from prominent Nazis, were mainly careerists from Government circles, such as Schlegelberger, the Under-Secretary of the Ministry of Justice, and University professors. The leaders of finance and industry were on the whole passive, though with some exceptions. Thus the prominent manager of a large insurance concern, Dr. Kiskalt, strongly advocated Nazi principles, whereas Dr. Schacht in spite of his exalted official position strongly opposed the application of Nazi slogans in the discussions of the Nazi Academy of German Law. In the end a kind of compromise was reached in the Company Law promulgated on the sixth anniversary of the Nazi accession to power, 30 January 1937, without previous discussion by the Reichstag under the powers granted by a law of 24 March 1933. This enactment, a systematic codification of company law in 304 sections, was to come into force on 1 October 1937. Many improvements introduced by the Emergency Order of 1931 were maintained. Use was also made of the results and conclusions of case law, and of the discussions of the German Juristic Congress (*Deutscher Juristentag*), and other pre-Nazi bodies. Nevertheless the influence of Nazi ideas was fairly strong.

Firstly, it was enacted that for the future companies cannot be formed with a smaller capital than M500,000. Existing companies are to be dissolved on 31 December 1940 should their capital not reach M100,000; they could, however, be converted into G.m.b.H.s. Furthermore the minimum par value of shares was increased to M1000, the amount provided by the law of 1884 and the Commercial Code of 1897 which was in force before the inflation. The Government was, however, empowered to grant at its own discretion exemptions both as to minimum capital and as to the par value of shares.

The power of general meetings was restricted. They could not give instructions as to future business policy, unless the board of management or the board of supervision should so request, or the two boards could not agree. If the draft balance sheet and profit and loss account are accepted by the board of supervision, the shareholders must accept them. The only right reserved to them is to resolve upon the payment of a smaller dividend than is proposed, a power which naturally would seldom if ever be exercised.

Under the earlier law members of the board of management could be removed at any time, either by the general meeting, or by the board of supervision. The sufficiency of the reason for removal was relevant only in respect of the removed manager's claim for compensation. According to sec. 75 of the new law the power to remove a member of the board of management is vested exclusively in the board of supervision, and cannot be exercised without some important reason. Even though a manager may have lost the confidence of the majority of the shareholders, they are unable to remove him, whereas the board of supervision may be removed at any time by a majority of three-quarters of the votes exercised.

Even if such a majority exists, it can force the issue only in a roundabout way; it must remove the board of supervision and elect members who will be subservient to the will of the majority. The new board will be in a position to oppose the balance sheet and profit and loss account, and thereby to give the shareholders in general meeting a chance of deciding on the yearly accounts and also of removing the managers. But dismissal of the recalcitrant managers before the expiration of their term of office is possible only for substantial reasons: mere dissatisfaction with their management is not enough, and to prove such substantial reasons will hardly be possible in the ordinary course of things. From a realistic standpoint, too, the removal of the board of supervision is outside the realm of possibility. A three-quarters majority apart from exceptional cases would be unlikely.

Again the law introduced some restriction on the exercise of votes based on shares deposited with banks, but they are not substantial enough to affect the existing practice by which banks could deposit large blocks of shares for general meetings in the case of all companies whose shares were listed on the Stock Exchanges and were popular with the public. Professor Jung, an author influenced by Nazi doctrines, stated that the law did not seriously reduce the power and influence of banks, and asserted that generally about 70 per cent. of the whole share capital of leading industrial companies was deposited for general meetings, mostly by banks in their own name.

The so-called protective shares (*Schutzaktien*) were on the whole maintained. Most illuminating, however, was the ambiguous attitude towards shares with plural votes. It was provided that such shares should not be issued for the future;

but the Government was empowered to grant exemptions. Similarly existing shares of this kind were to be gradually withdrawn, that is, either redeemed or deprived of plural votes. But it was left to the Government to decide when and under what conditions they should be redeemed; and the Government made no use of the authorisation. It is not surprising, then, that shares with plural votes continued to dominate the field. Jung asserts that 70 per cent. of German companies were ruled by such shares. The most powerful German company, I.G.-Farben, with an issued capital of M1165 millions, is an example of how far their use, or rather abuse, was going. M1125 millions of share capital had 11,250,000 votes, whereas 400,000 preference shares with plural votes gave 5 million votes for M40 millions of capital. In order to defeat the votes of the management and board, even if they did not deposit a single share beside the preference shares, an opposition representing M500 millions, or over 40 per cent. of the share capital, would have been necessary. Obviously the organisation of so powerful an opposition was impracticable. Management and board had after all some holdings in ordinary shares, and the banks had large portfolios of shares deposited with them by their customers. The shareholders were practically disfranchised, and the case of I.G.-Farben was far from being the worst. In fact the powers of management and board were immensely strengthened as against the owners of the share capital, and of those two the management was granted the upper hand by the practical abolition of the power to remove it. If the power of control within the company means the power to hire and fire, as an American lawyer put it, that power was practically extinct.

It is not surprising that an American social philosopher, James Burnham, came to the conclusion that the revolution in Germany was on the whole a managerial one, a revolution of managers of companies, who fought for power and succeeded. In the light of the facts, however, this seems an exaggeration. It is true that the boards of management became stronger, and the powers they had previously possessed if and when strong personalities were on the board were now secured by law. But it was not the managers who made, or who gained by, the Nazi revolution. German company managers formed on the whole a very small class. At the end of 1937 there was a total of 622 German companies with a capital exceeding M5 millions,

or £250,000 at the normal rate of exchange, and of these only 172 had a capital of over M20 millions. Such a small fraction was obviously not in a position to start a revolution. Again, far from its having been the German managerial class which financed the Nazi revolution, it was the industrial capitalists who were the main supporters of the Nazi party. Moreover, it was not the managers who became the governing class; even those of them who obtained leading governmental posts soon fell from power, and within a short time prominent Nazis filled all influential posts in various companies.

The only bright spot was that the law set an indirect limit to the amount which the managers and supervisors might appropriate from the company's profits. It was provided that the salaries and *tantièmes* should be in a proper proportion to the salaries and wages of employees. But as far as we know in no case did the Public Prosecutor take action to reduce salaries and *tantièmes*.

The effect of the law was in practice very favourable to the management, and it is no wonder that those who were not excluded for political or racial reasons from such posts were well satisfied with the position and made good use of its possibilities. The infiltration of Nazi bosses into companies and the substantial amounts paid to them were after all at the shareholders' charge, and shareholders' interests, both in law and in practice, were the last to be considered.

A curious feature of the law is its use of high-sounding but quite meaningless statements. The management should always act in accordance with the interests of the enterprise, the benefit of the workers and employees, and the common good of the people and the Reich. How this was to be decided is not stated, and the interests of the shareholders are not even mentioned.

The doctrine that disclosure of accounts and reports may be omitted if it be contrary to the interest of the company, the enterprise as such, or the common weal, was maintained. Furthermore it was enacted that shareholders are to be excluded from voting should their votes be used to further interests extraneous to the company.

In short, besides codifying many well-known rules evolved by the judicial decisions and literature of earlier times, the law introduced startling new provisions tending to distort both the legal and economic structure of corporations, and in the words

of the old maxim it may truly be said that what was good in the law was not new, and what was new was not good.

Within six months of the coming into force of the law Austria was overrun, and in September 1938 German company law was introduced there. The Reich economy was put on a war footing, and in September 1939 the Second World War began.

The supporters of Fascist ideas in the matter of company law may explain their total failure by the advent of war. But the normal effect of a wartime economy would be to strengthen the corporate device, since all industrial companies were working at their utmost capacity, and price control, though possibly limiting profits, would operate in any case to secure moderate returns. On the other hand losses on credits were made practically impossible. In spite of this fact the number of companies was, so far as we know, constantly on the decrease. In 1941 it was stated that since 1933 4000 companies (A.G.s and K.A.G.s) and 17,000 G.m.b.H.s had disappeared, only 28,869 companies and G.m.b.H.s remaining in existence. Unfortunately the exact number of companies and G.m.b.H.s is not known, but it is significant that the total capital of both categories amounted only to about 26,000 million marks.

In 1941 all prices were already on the increase, and wartime legislation gave general permission to all companies to revalue their assets in order to bring them up to the existing price level. At the end of 1942 the aggregate company capital amounted to 28,700 million marks, of which 4100 millions resulted from rectifications. At the end of 1944 the aggregate capital was reckoned at 30,000 million marks. Some companies had indulged in a rectification of 300 per cent., and there were hardly any which had not written up their assets by 20 per cent.

Although the limitation of dividends introduced in 1934 came to an end, in 1941 special surtaxes for dividends in excess of 7 per cent. were introduced at such rates that increased dividends were practically prevented.

The systematic campaign against shareholders did not fail to bear fruit. At the beginning of 1944 a leading Nazi expert stated that three-quarters or even more of the aggregate capital of companies was owned by majority shareholders, public bodies or other companies. The general public did not own more than 20–25 per cent. of the share capital. Even more significant is another statement that in the creation of new companies and in

increases of capital by issue of new shares individuals took no part at all. The new capital was usually subscribed by existing companies, by capitalists holding large blocks of majority shares, or by public bodies. The essence of corporate enterprise, the collection of small contributions from a large number of investors, was perverted. Companies were no longer instruments for the accumulation of collective means, but devices to secure the privilege of limited liability for a class of favoured individuals.

Nazi legislation did not hesitate to draw the consequences, and first the category of the family company was introduced by an Order. Companies whose capital was owned by members of a single family were to be exempt from a number of regulations, especially as to publicity. The first company to be granted this privilege was of course the great Krupp A.G. Similarly, wide privileges to the same effect were granted to companies with not more than five shareholders. The iron and steel concern owned by Flick, one of the big capitalists who financed the Nazi struggle for power, was naturally the first, and possibly the only one, to be granted this privilege.

An Order of the Reich Ministry of Justice issued in 1944 suspended general meetings altogether. This measure was but an open declaration of the actual position.

The effect of the collapse following on Germany's surrender cannot yet be foretold. In the author's view, however, one thing is clear: if recovering German economy is to be based upon corporate enterprise, it must be on quite different lines.

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24. VICHY LEGISLATION

The Vichy régime undertook the reform of French company law, and between November 1940 and March 1943 no less than eight Laws and Decrees were promulgated. It seems that apart from the desire to eliminate certain abuses, these measures were

the product of a tendency to strict authoritarian regimentation due either to pressure from the occupying Power or to sympathy with the Nazi spirit. It would be pointless to deal with the reforms in their chronological order, since some of the provisions adopted were subsequently amended, and it seems preferable to give a short summary of the changes made in the law.

Under French law companies had not been compelled to call up the unpaid remainder of their shares. By the law of 4 March 1943 any remainder is to be called up within five years after the registration of the company, or of an increase of its capital by the issue of additional shares respectively. So long as the shares are not fully paid up, the company may not issue bonds, or increase its capital by issuing additional shares. This rule was to apply not only to new companies but to all those already in existence. The old rule by which 25 per cent. of the par value was to be paid up at the formation of the company was maintained, with the amendment that if shares are issued with a premium, the premium is also to be paid up with the 25 per cent.

Vichy legislation looked upon bearer shares with strong disfavour. As early as 28 February 1941 it was provided that they may not be negotiated, unless deposited with a French bank or a company of brokers authorised by the Government. Bearer could be converted into registered shares, and thus exempted from the restriction. On 3 February 1943 the conversion of bearer shares into registered shares was made compulsory, unless they are deposited with a central institution for the deposit and transfer of securities, such institution issuing to the depositors nominative certificates in their place. After the term fixed for the deposit, bearer shares were not to be transferable *inter vivos*. Any sale of shares was to be effected only by authorised brokers, who must record it. Such record is to be refused if the transaction is not in accordance with the prescribed minimum or maximum price of the security.

To reduce interlocking shareholdings it was provided by a law of 4 March 1943 that if a company has an interest of 10 per cent. or more in another company, it must inform the latter of the acquisition of the said percentage. The informed company may not acquire shares in the company holding such percentage of its shares, and should it already be in possession of any, the holding is to be reduced to below the 10 per cent. limit either by sale on the market or by surrendering the excess in question

to the other company in reduction of capital, of course against payment.

The most trenchant provisions concern company management. There was strong criticism in France of the number of directors, and also of directors' fees, which were regarded as unproductive. In France executive managers were not as a rule members of the board of directors.

The new legislation limited the maximum number of directors to 12,[1] providing also that no person may be on the boards of more than eight companies registered in France. Insurance companies in the same concern and bearing the same name were to be accounted as one company (e.g. the Compagnies Nationales for various kinds of insurance, such as life, fire, transport and so on).

By the law of 1940 the president of the board is to be responsible for the management; the board may, however, appoint a general manager beside the president, to whom the management may be entrusted with full responsibility. But in 1943 the president was made to remain responsible for the management even if a general manager is appointed. Henceforth general managers could either be members of the board or not, as the company might choose, whereas earlier a member of the board could not fill the post of general manager, and it was usual to delegate one or several members of the board to take part in the management. These were not managers, but only delegated directors (*administrateurs délégués*).

The president is empowered to appoint a committee composed of directors or employees, or both, for the study of questions defined by him. He can also delegate all or part of his powers to a director, but only for a limited time. In spite of these provisions the power and responsibility of management of the affairs of the company remains vested in the president. His responsibility goes so far as to involve the disabilities of bankruptcy in case of the company's insolvency, unless the Court should exempt him on evidence that the bankruptcy of the company is not due to his negligence. Furthermore, if in case of bankruptcy or compulsory winding-up the assets of the company should not be sufficient to meet its debts, the Court may declare the president liable for the debts unpaid, unless he can prove that he applied to the management all the diligence and activity of a salaried agent.

[1] Law of 16 November 1940.

All these consequences fall equally upon the members of the board, in so far as they have been delegated by the president and have taken part in the management. The Court's power to declare the president liable for unpaid debts extends also to directors taking part in the committee, and even without it the Court may at its discretion impose upon them the liability of joint and several debtors. No person may be president of more than two French companies at the same time.

It is not quite consistent with the great power of the president over the board of directors that the latter may at any time and even without any ground revoke his nomination and thus reduce him to a simple member of the board.

Parallel with this strengthening of liability, directors' fees were reduced in 1943. The law of March 4 provided that fees for attending meetings should not exceed the amount fixed in general meeting for this purpose. The *tantièmes* of members of the board are not to exceed 10 per cent. of the excess net profits over the amount put to legal reserve and a dividend of at least 5 per cent., or such dividend as the articles provide. The board has power to distribute the *tantièmes* at its discretion, and especially it may appropriate higher fractions to those members to whom managerial duties have been delegated.

These reforms were intended to be permanent provisions for the regulation of companies; apart from them, several wartime provisions were enacted, the most important being a law limiting dividends and directors' fees for the duration of the war. These provisions are very similar to those of the German law of 1934.

The Vichy laws remained on the whole unchanged after the liberation of France. Some of the wartime restrictions, such as those directed against the issue of additional shares, have been cancelled, and others introduced to meet actual or imagined emergencies.

A co-ordination and consolidation of French company law seems inevitable. It will undoubtedly be affected by the trend of economic policy, particularly in the direction of nationalisation, and its future evolution is so far quite obscure.

SOURCE

G. Ripert, *Aspects Juridiques du Capitalisme Moderne* (1946), pp. 48–123, 259–340.

25. Survey of Other Company Legislations

The preceding sections have dealt with the corporation and company laws of those countries which played a leading part in the evolution of corporate enterprise. We have now to cast a glance at the laws of other countries which followed more or less closely one or other of these.

The members of the British Commonwealth of Nations have adopted in essentials the principles of English company law, and local differences are of minor importance. Thus the Canadian Company Act, 24–25 Geo. V, c. 33 (1934), amended by 25–26 Geo. V, c. 55 (1935), permits the creation of companies with shares of no par value.

The Companies Act of the Union of South Africa (Act 46 of 1926), amended by Act 11 of 1932 and by Act 23 of 1939, contains *inter alia* specific provisions regulating the form and contents of balance sheets and accounts.

India has an exhaustive Companies Act which is on the whole identical with English law.

New Zealand has a Companies Act (24 Geo. V, No. 29) which was amended and supplemented by Act 25 Geo. V, No. 6, on special investigations, No. 28 on temporary receivership, No. 39 on bondholders' incorporation and No. 51 on special liquidations. Palestine similarly has a Companies Act, but in Australia company law is still not a subject of Federal legislation.

French legislation has had a tremendous influence all over the world. The *Code de Commerce* and the Company Law of 1867 dominated Belgium, Spain, Portugal, Rumania, Yugoslavia, Turkey and also Italy, though the last-named country later developed its law on new lines, partly under the influence of German company law. Dutch law was until recently a replica of the *Code de Commerce*. The company legislation of Mexico and South America is also dominated by French legal concepts.

The German orbit is also fairly large. The German Commercial Code of 1861 has been adopted by Austria and remained in force until the *Anschluss*; its provisions as to corporations were never altered. In particular the requirement of Government assent for company formation was always retained. In 1899 the Austrian Government issued a "regulative" fixing the conditions

for granting of the concession. In the other state of the Dual Monarchy, Hungary, the Commercial Code of 1875,[1] in its provisions relating to companies (secs. 147–222), is based on the German law as then in force, i.e. the company law of the German Commercial Code as amended by the law of 1870; it shows, however, some traces of the influence of English and Belgian law. It is still in force. After the war of 1914–18 both Austria and Hungary suffered currency depreciation, and had to make provision for the readjustment of company capital, which was done in 1925. In both countries company reform was needed: in Hungary a draft law was prepared in 1932 by Professor Kuncz, but was never accepted by the Government.

Swiss company law occupies a special place within the German orbit. The first Federal regulation was made by the enactment of the Swiss Law of Obligations (OR) in 1881, which came into force on 1 January 1883. Until that time company law was within the competence of Cantonal legislation. The law in question completely [2] codified the law of companies proper (A.G.), and of K.A.G.s. Chapter 27 regulated the legal position of co-operatives. The revision of the Swiss Law of Obligations in 1911 which followed on the adoption of the Swiss Civil Code did not include company law. A resolution of the Federal Council of 8 July 1919 sought to eliminate certain abuses which grew up in the post-war boom. Public opinion regarded company law amendment as overdue, and on 21 February 1928 a draft was submitted to the Federal Assembly, including an amended text of chapters 26–38 of the Law of Obligations. The Assembly enacted the new law on 18 December 1936: it came into force on 1 July 1937. It introduced many amendments in company law, some of them both material and technical improvements. Although dominated by German legal traditions, it is distinguished by great clarity, simplicity and precision.

The company laws of the Scandinavian countries, though based upon German legal ideas, show similar independence in many respects. Sweden in 1944 enacted a comprehensive codification which came into force on 1 January 1948.

Poland in 1928 passed a new company law substantially similar to the German law, though adopting original solutions of some questions.

[1] Law XXXVII ex 1875.
[2] Chapter 26, sections 612–677.

The U.S.S.R. includes company law in its Civil Code, which was in operation during the so-called NEP period. Although never repealed, it has nowadays no application whatsoever, in consequence of the nationalisation of Russian economy. (See § 30.)

CHAPTER II

PRIVATE CORPORATIONS IN MODERN SOCIETY

26. The Corporate Sector of National Economy

As a result of the trend referred to in the previous chapter, corporate enterprise invaded every sector and branch of economic activity, nowhere more than in the U.S.A. This was emphatically stated by Justice Field [1]: "As a matter of fact nearly all enterprises in this state (U.S.A.) requiring for their execution an expenditure of large capital are undertaken by corporations. They engage in commerce, they build and sail ships, they cover our navigable streams with ships, they construct houses, they bring the products of earth and sea to market, they light our streets and buildings, they open and work mines, they carry water in our cities, they build railroads and cross mountains and deserts with them, they erect churches, colleges, lyceums, and theaters, they set up manufactories and keep the spindle and shuttle in motion, they establish banks for savings, they insure against accidents on land and sea, they give policies on life, they make money exchanges with all parts of the world, they publish newspapers and books and send news by lightning across the Continent and under the Ocean."

In other countries this trend never produced such striking effects, and in time it was reversed. The telegraph was from the beginning a State monopoly in most countries, and the telephone, though introduced by private enterprise, was taken over by the State authorities as a branch of their postal services. For railways, nationalisation, initiated in Germany by Bismarck in the 1870s, was adopted by nearly all European States except France, and a similar course was followed with respect to public utilities. Nearly all waterworks and most electricity and gas undertakings and street tramways were taken over by the municipalities. Thus by about 1939 there were already sub-

[1] San Mateo County *v.* Southern Pacific R.C. (R.R. Tax cases), 13 Fed. 722 at 743.

stantial differences between the various countries as to the extent of corporate enterprise.

A sweeping change, however, took place after the Second World War. On the Continent much large-scale enterprise was nationalised or is now on the way to nationalisation. In Great Britain the shares of the Bank of England and the Cable and Wireless Company were purchased compulsorily by the State, while the coal-mining industry, electric light and power production and distribution, gas, railways and canals and long-range road transport enterprises have been taken over by State-owned boards. Thus important branches of economic activity are already outside the field of business corporations, and it cannot yet be foreseen how far this reversal of the trend will go. There is a strong tendency in favour of the nationalisation of the iron and steel industry. These developments must be borne in mind in trying to delimit the corporate section of national economies in our age.

A further difficulty arises from the fact that there is no uniformity in statistics. Generally, only data as to the capital of companies are collected, while for the U.S.A. the amounts of their assets are also known. Moreover, the particulars published relate to various periods and are partly out of date. Thus the latest published statistics for Great Britain are made up only to the end of 1938. At that time registered public companies not in liquidation or in course of removal from the register numbered in England 15,872, in Scotland 1620; total 17,492. Public companies in liquidation or in course of removal from the register numbered 1249 in England, 74 in Scotland; total, 1323. The number of private companies in England was 134,882, in Scotland 8378; total, 143,260.

The paid-up capital of 13,018 public companies registered in England amounted to £3,801,209,452, and of 1337 public companies registered in Scotland to £295,596,136: total for Great Britain, 14,355 and £4,096,805,588 respectively. For private companies the figures available are: 134,843 active private companies registered in England had a paid-up capital of £1,741,584,845; 378 private companies in Scotland had a paid-up capital of £152,153,168; total for Great Britain, £1,893,738,013. Thus the aggregate paid-up capital of companies registered in Great Britain amounted on 31 December 1938 to £5,990,543,601. The amount of reserves was not

disclosed, nor are any data available as to profits or losses not consolidated by reduction of capital or otherwise. The picture is therefore far from complete. Furthermore, as is well known, many companies have consolidated debts in the form of debentures, and owing to this omission we have no precise knowledge of the capital invested in British private corporations. The particulars relating to railways are not included.

The evolution from 1930 onwards is shown in Table IV of the Annual General Report for 1938. At the end of 1930 16,263 public companies in Great Britain had a paid-up capital of £3,893,937,846, and 95,398 private companies an aggregate paid-up capital of £159,511,832. The number of public companies was on the decrease, though it rose slightly from 14,695 in 1935 to 14,742 in 1936, only to fall again in the following years, whereas the capital invested in public companies increased slightly, i.e. from £3,893,937,840 to £4,096,805,588. It is to be noted, however, that the years 1932, 1933 and 1934 show a moderate decrease, i.e. from £3,896,511,832 in 1931 to £3,850,666,935 in 1934, thereafter to rise once more, though within moderate limits.

As to private companies, there is an uninterrupted increase both in number and capital. At the end of 1930, 95,598 private companies had an aggregate paid-up capital of £1,590,511,832; at the end of 1938, 143,221 had a paid-up capital of £1,893,738,013.

For 1939 and the following years there is very little information. According to the official data furnished to the Cohen Committee, in 1939 there were 13,920 public companies with a paid-up capital of £4117 millions, and in 1944 13,303 with a capital of £4052 millions. Private companies on the other hand numbered 146,735 in 1939 and 169,205 in 1944—their capital amounting to £1923 and £1935 millions respectively. Thus the five war years brought about a decrease both in numbers and capital of public companies, whereas there was a considerable increase in both for private companies, with a large decrease of the average capitalisation to about £11,470.

A realistic view of the importance of the corporate sector in industry could be gained only if we knew not merely the paid-up capital of companies but also the aggregate amount of their assets, and could compare this with the estimated national wealth. But in actual fact particulars of company assets have never been compiled, or at any rate published, for Great Britain, while the

estimates of the national wealth are rather vague, and moreover are not up to date.

Robert R. Doane [1] put the total wealth of Great Britain in 1929 at $90,225 millions, i.e. roughly a little over £18,000 millions. The aggregate paid-up capital of English and Scottish companies, excluding railways but including those in process of winding-up, amounted at the end of 1929 to roughly £5200 millions, i.e. about 28·9 per cent. of the estimated total national wealth. Professor Hicks [2] gave for the years 1932–4 an estimate of £24,500 millions, in which the national debt of £6000 millions and the foreign assets are included, but Britain's external debt to the U.S.A. is disregarded. Public property excluding armaments and roads figures in this estimate at £2000 millions. Since the aggregate corporate capital at the end of 1932 was £5,536,990,762; in 1933 £5,562,429,827; in 1937 £5,547,350,147, there is a slightly increased percentage of about 30 per cent. But we must remember that reserves, open or secret, are not accounted for. The percentage is substantially higher if corporate capital is compared with private property; it is then about 33·6 per cent.

As to size, the trend was in the direction of a slight increase in the capital of public and a marked decrease in that of private companies. This is clearly shown by the particulars of new registrations during 1929–38.

In England newly registered companies classified according to the amount of their nominal capital give the following picture, as shown on pages 228 and 229.

The influx of large numbers of small companies had as its result that, although the average paid-up capital of public companies increased from £249,000 in 1930 to £256,000 in 1934, £296,000 in 1939 and £304,000 in 1944, average capital of private companies decreased from £16,900 in 1930 to £14,700 in 1934, £13,100 in 1939 and £11,400 in 1944. Consequently the average capital of all companies, public and private, decreased from £49,400 in 1930 to £42,500 in 1934, £37,700 in 1939 and £32,800 in 1944.

For the U.S.A. there is no comprehensive official statistical survey of new corporations or of the number of existing corporations. This is a natural consequence of the constitutional powers reserved to the separate States. On the other hand the Bureau

[1] *Measurement of American Wealth* (1933), p. 33.
[2] *The Social Framework,* Oxford (1942).

For England the figures are:

TABLE A

COMPANIES REGISTERED IN ENGLAND WITH A SHARE CAPITAL DURING THE YEARS 1929–38 CLASSIFIED ACCORDING TO THE AMOUNTS OF THEIR NOMINAL CAPITAL

Nominal Capital (£)	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
under 1,000	2,521	2,763	3,101	4,219	4,458	4,517	4,619	4,958	4,822	5,046
1,000 ,, 5,000	3,388	3,408	3,408	4,066	4,621	5,107	5,414	5,496	5,101	5,104
5,000 ,, 10,000	983	893	784	822	991	1,167	1,183	1,326	1,188	1,132
10,000 ,, 20,000	718	626	518	530	646	763	834	903	793	640
20,000 ,, 50,000	422	352	284	275	320	424	481	498	382	370
50,000 ,, 100,000	193	109	98	99	114	154	169	182	133	100
100,000 ,, 200,000	141	77	57	61	83	106	158	144	111	67
200,000 ,, 300,000	79	40	8	25	30	47	67	49	34	17
300,000 ,, 400,000	25	10	7	7	17	28	25	30	10	8
400,000 ,, 500,000	19	2	6	3	8	10	8	11	6	2
500,000 ,, 750,000	20	9	2	5	15	20	21	15	10	9
750,000 ,, 1,000,000	10	2	2	3	2	4	7	5	7	2
,000,000 and above .	44	10	7	6	8	21	14	20	17	4
Totals . . .	8,563	8,301	8,282	10,121	11,313	12,368	13,000	13,637	12,614	12,501

For Scotland the figures are:

TABLE B

COMPANIES REGISTERED IN SCOTLAND WITH A SHARE CAPITAL DURING THE YEARS 1929–38 CLASSIFIED ACCORDING TO THE AMOUNTS OF THEIR NOMINAL CAPITAL

Nominal Capital (£)	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
under 1,000	90	125	122	132	160	191	184	191	180	196
1,000 ,, 5,000	127	144	153	167	224	212	235	232	205	227
5,000 ,, 10,000	65	66	56	54	64	86	82	70	88	86
10,000 ,, 20,000	62	59	41	34	48	50	59	71	68	58
20,000 ,, 50,000	45	27	21	25	19	23	36	37	45	44
50,000 ,, 100,000	14	9	1	2	14	10	7	12	7	12
100,000 ,, 200,000	6	7	1	2	9	10	4	6	5	5
200,000 ,, 300,000	3	—	—	4	—	2	3	3	4	1
300,000 ,, 400,000	2	—	—	—	—	1	—	1	—	—
400,000 ,, 500,000	—	—	—	—	—	—	—	—	3	—
500,000 ,, 750,000	3	1	1	—	1	—	2	—	1	—
750,000 ,, 1,000,000	—	—	—	—	—	—	—	—	—	1
1,000,000 and above .	2	1	2	—	—	—	1	—	—	1
Totals . . .	419	439	398	420	539	585	613	623	606	631

of Internal Revenue releases annual particulars of the returns for Federal Income Tax and Excess Profits Tax, relevant parts of which are reproduced in the *Statistical Abstract of the U.S.A.*

The data of the Internal Revenue Bureau presumably include most of the business corporations, and these particulars give more details than the Annual General Reports of the Registrar of Companies in Great Britain. From these publications we extract the following data:

TABLE C

ASSETS AND CAPITALISATION OF AMERICAN CORPORATIONS

Year	*Number*	*Number of Balance Sheets Filed*	*Total of Assets*	*Total of Preferred Shares*	*Total of Common Shares*	*Surplus, Surplus Reserve, Surplus and Undivided Profits*	*Deficit*	*Net Surplus*
			In Millions of Dollars					
1928	443,611	384,548	307,218	18,475	77,256	52,069	4,913	47,156
1929	456,021	398,815	335,778	19,738	85,520	60,699	5,588	55,111
1930	463,036	403,173	334,002	19,117	87,067	61,832	6,734	55,098
1931	459,704	381,088	296,497	19,217	79,494	51,976	7,624	44,352
1932	451,884	392,021	280,083	19,076	78,413	45,664	9,584	36,080
1933	446,842	388,564	268,206	18,394	74,088	44,792	9,696	35,096
1934	469,804	410,626	301,307	19,976	84,970	48,986	12,347	36,639
1935	471,113	415,205	303,150	19,533	82,733	48,828	12,163	36,665
1936	478,857	415,654	303,180	18,591	78,072	48,043	11,237	36,806
1937	477,838	416,902	303,157	18,364	77,339	58,524	12,594	45,930
1938	471,032	411,941	300,022	18,108	74,792	57,669	13,131	44,537
1939	469,617	412,759	306,801	17,213	73,482	59,191	13,022	46,169
1940	473,042	413,716	320,478	17,318	72,293	61,663	12,676	48,957
1941	468,906	407,053	340,452	16,214	71,577	66,258	11,858	54,800
1942	442,665	383,534	360,618	15,473	68,782	68,782	10,454	58,328
*1943	455,894	366,870	389,523	15,067	64,481	75,836	9,720	66,116
*1944	446,792	363,056	418,324	15,112	64,785	79,756	9,194	70,562

* The particulars for 1943 and 1944 are taken from the releases of the Treasury Department, Washington Press Service Nos. S. 120, 121, 122 ex 1946; S. 484 ex 1947, placed at the author's disposal by courtesy of the Bureau of Internal Revenue. They may be subject to corrections.

The number of corporate entities during the whole period was considerably higher, since a large number of them were inactive, as is shown in the following table:

TABLE D

INACTIVE CORPORATIONS

Year	
1928	52,280
1929	53,415
1930	55,700
1931	56,700

Year	
1932	56,752
1933	57,238
1934	59,094
1935	56,578
1936	57,922
1937	51,259
1938	49,469
1939	46,343
1940	43,744
1941	40,160
1942	37,012
1943	35,268
1944	34,329

It we wish to compare the volume of the assets held by corporations with the total national wealth of the U.S.A., we meet with the same difficulty as in Great Britain. The last time that an official estimate of the entire capital of the nation was attempted was in the census of 1920. At the end of that year the national wealth of the U.S.A. was estimated at $353,000 millions, consisting of realty estimated at $230,000 millions and personalty amounting to $123,000 millions. At the same time the aggregate amount of corporate assets was given as $102,000 millions.

It has, however, been recorded that even by the end of 1919 86·6 per cent. of the wage-earners engaged in industrial production were employed by corporations, and that the value of the products of corporations amounted to 87·7 per cent. of the total industrial production, so that nearly nine-tenths of American industry was handled by corporations. These figures show a considerable increase of the corporate sector over the census of 1899. At that time the ratio of wage-earners was about 65 per cent. and that of the value of manufactured products 66·7 per cent.

The decade 1920–9 was characterised by a further increase in the importance of corporations. The National Industrial Conference Board estimated the national capital at the end of 1928 as $360,062 millions, and concluded that by the end of 1929 it may have reached $367,000 millions. The value of the net assets of American corporations according to Professor C. G. Means was in the neighbourhood of $165,000 millions.

The particulars of tax returns show that the aggregate amount of the preferred and common stocks of corporations together with their surplus included in the tabulation at the end of 1928 was about $150,000 millions, and at the end of 1929 $160,000 millions.

The impact of the collapse of the security markets and the

ensuing depression is clearly shown not so much in the absolute number of active corporations as by the value of their gross assets and their capitalisation. The aggregate value of corporate assets at the end of 1929 was \$335,478 millions, on 31 December 1933 \$268,206 millions; the aggregate amount of capitalisation (i.e. preferred and common stock, plus surplus) \$160,369 and \$127,578 millions respectively. The recovery of the middle thirties did not fully restore the position. At the end of 1937 the aggregate value of the assets was only \$303,180 millions, and of the capital and surplus \$133,469 millions. It was only in 1941, when the rearmament programme and the help given to the Allies were in full swing, that the 1929 level was equalled and slightly surpassed, the value of the assets reaching \$340,452 millions, though capital and surplus amounted only to \$142,591 millions.

The war years show substantial increases in the value of assets, but not in capital and surplus. Thus for the end of 1944 the assets are given as \$418,324 millions, the capitalisation as only \$150,459 millions. Even this increase is due only to the accumulation of surplus, which reached \$70,562 millions in comparison with the \$55,111 millions of 1929, whereas both preferred and common stock declined, the former to \$15,112, the latter to \$64,785 millions. The amounts for 1929 were \$19,738 and \$85,520 millions respectively. The ratio of net surplus to stock considerably improved.

As we have said above, since the census of 1920 there has been no similar valuation of the national wealth, and we have to agree with Doane,[1] who found it deplorable that in 1932 the statistics of the aggregate wealth of the U.S.A. were omitted. His own estimate for the end of 1930 was \$426,343 millions, whereas his earlier work, *Measurement of American Wealth*, gives for the same period an estimate of \$392,500 millions. Thus every attempt to determine the portion of the national wealth invested in corporations yields only vague results.

More precise data were produced in the course of the investigations of the Temporary National Committee set up by Public Resolution No. 113 of the Seventy-fifth Congress to study the concentration of economic power. According to the estimate of Dr. W. L. Thorp of the Bureau of Foreign and Domestic

[1] *Anatomy of American Wealth* (1940), p. 17.

Commerce,[1] altogether from 60 to 65 per cent. of the total business of the U.S.A. is done by corporations.

Among the various fields of economic activity, the share of corporate business was 100 per cent. in electric light and power, the same in manufactured gas (both production and distribution) and in communications, 96 per cent. in mining, 92 per cent. in manufacture, 89 per cent. in transport, 84 per cent. in finance, 58 per cent. in trade, 36 per cent. in construction, 30 per cent. in service, 7 per cent. in agriculture and lastly 33 per cent. in the group of miscellaneous enterprises.

The trend of evolution undoubtedly was for the role of corporations to increase steadily and that "the position of the individual man in all types of American industry has been steadily growing less and less important, while the position of the large corporation has been growing more and more important".[2]

Simultaneously with the invasion of the economic field by corporations, large corporations acquired an increasing weight within the corporate sector itself. The statistics of income published by the U.S. Treasury Department report for 1937 that, of 228,721 corporations, 55 per cent. owned less than 1½ per cent. of the total assets, each of them with assets of under $50,000. On the other hand the 394 largest corporations, less than one-thousandth of the total, held almost 45 per cent. of all corporate assets.

The particulars published for the year 1944 show a smaller number of corporations with assets under $50,000, namely 176,212 out of 363,056 which filed their balance sheets, their total assets amounting to $3,528,237,000 out of $418,324,088,000. In other words, corporations representing 48·5 per cent. of the total in number held approximately only 0·844 per cent. of the assets. In the same year 517 corporations with assets of at least $100 millions held aggregate assets amounting to $219,462,255,000, their number representing 1·4 per thousand and their assets about 52·4 per cent. of the total.

With regard to the proportion of profits Berle and Means,[3] on the basis of the Income Tax Statistics for 1929, found that the largest 200 non-financial corporations with an income of $5,000,000 or more received in that year 43·2 per cent., and they state that

[1] See *Final Report*, p. 678, and David Lynch, *The Concentration of Economic Power* (Columbia University Press, 1946), p. 94.
[2] *T.N.E.C. Final Report*, p. 678.
[3] P. 29.

this share would have been larger if the incomes of subsidiaries were added to those of the respective parent corporations. The Income Tax Statistics for 1937 show that 248 corporations with incomes of $5,000,000 or more had 40 per cent. of the total income of 192,028 corporations which reported incomes. On the other hand corporations with incomes under $5000 each, representing 65 per cent. of the said 192,028 corporations, had less than 2 per cent of the total income.[1]

The increased prosperity of the war years gives a somewhat different picture. In 1943 391 corporations reported incomes between $5 and 10 millions, and altogether 781 corporations had incomes of $5 millions or more. These corporations represented 2·75 per thousand of the the 243,735 corporations reporting incomes and their aggregate income amounted to $2,745,948,000 and $12,266,904,000, or $15,012,852,000 in all, that is about 52·3 per cent. of the total income of $28,717,966,000.[2] The data for 1944 are: Number of corporations reporting incomes between $5 and 10 millions, 348; of corporations with returns of $10 millions or more, 357. The aggregate income of the former class was $2,595,684,000, or the latter $10,758,631,000; $13,354,315,000 in all. 705, that is roughly 2·44 per thousand of the 288,904 corporations reporting an aggregate income of $27,123,741,000, received 49·3 per cent. of the total income.[3]

It is too early to predict whether the trend of the post-war reconversion will be in favour of the large corporations or not.

It may be interesting to reproduce some data as to the volume of the largest giant corporations. Berle and Means [4] have recorded the value of the gross assets of the 200 largest non-banking corporations for 1930, and the final report of T.N.E.C.[5] gives particulars of the 30 largest corporations (including insurance and banking corporations) for 1935. Here we reproduce the particulars for 1935 as therein contained, giving in brackets the comparative data for 1930 as far as collected by Berle and Means:

	Thousand Million Dollars
Metropolitan Life Insurance Co.	4·23
American Telephone and Telegraph Co.	3·99 (4228·4)
Prudential Insurance Co.	3·12
Pennsylvania Rail Road Co.	2·86 (2·6 est.)
New York Central Rail Road Co.	2·35 (2·25)
Chase National Bank	2·33

[1] *T.N.E.C. Final Report*, p. 679.
[2] Release No. S. 120, p. 11.
[3] Release No. S. 484, p. 28.
[4] Pp. 19–24.
[5] 15676 (7).

	Thousand Million Dollars
New York Life Insurance Co.	2·22
Standard Oil of New Jersey	1·89 (1·7673)
National City Bank of New York	1·88
Guaranty Trust Co.	1·84
Equitable Life Insurance Co.	1·82
U.S. Steel Corpn.	1·82 (2286·1)
Allegheny Corpn.	1·73
Southern Pacific Rail Road Co.	1·67
General Motors Co.	1·49 (1·4 est.)
Consolidated Edison Co. of New York	1·38
Bank of America	1·27
Mutual Life Insurance of New York	1·24
Commonwealth and Southern Corpn.	1·17 (1·1337)
Great Northern Railway Co.	1·15 (0·8124)
Continental Illinois National Bank and Trust Co. of Chicago	1·14
Northern Pacific Railway Co.	1·13 (0·8428)
Associated Gas and Electric Co.	1·11 (0·9004)
Baltimore and Ohio Railroad Co.	1·11 (1·0408)
City Service Corpn.	1·09 (0·9896)
Atchison, Topeka and Santa Fe Rail Road Co.	1·07 (1·1354)
Northwestern Mutual Life Insurance Co.	1·07
Union Pacific Rail Road Co.	1·07 (1·1211)
North American Co.	1·04 (810·3)
Bankers Trust Co.	1·03

For industrial corporations there was no continuation of the upward trend so conspicuous in the decade 1919–28 and especially in the years 1924–9, and the estimates of Berle and Means as to the continuation of that trend were not realised. Even so it is a fact that in the U.S.A. the corporate sector of national economy is larger than anywhere else, and is mainly dominated by large corporations.

The Second World War and its aftermath caused such an upheaval of all economic conditions in Europe that an analysis of the position as it existed before then would be of merely historical interest. The giant corporation, however, was not unknown. Thus in Germany the dye trust, I.G.-Farben, with its wide national and international ramifications, perhaps played a much larger role in the economic life of the country than any similar enterprise in Great Britain or the U.S.A. The big steel trust of the Rhineland was also of great absolute, though smaller relative importance.

In little inter-war Austria the leading iron and steel enterprise, the Alpine Montan Co., had a domain amounting to a small province, controlling not only iron and steel production but also through its army of employees and workers exercising a far-reaching political influence. Austrian capital was not sufficient to finance this giant enterprise; it came first under Italian and subsequently

German influence and was an important means of extending Nazi domination to Austria.

A distinctive feature of corporate enterprise in Germany and its satellites was the dominant role of the banks. Nearly all the leading banks acquired substantial interests in the more important industrial corporations, so that they were not only creditors but shareholders also. In many cases banks had substantial holdings, and by virtue of their own blocks of shares and the holdings of their clients were able to dominate the general meetings of the companies concerned.[1] The Hungarian Government justifies the nationalisation of the commercial banks of that country by the fact that about 80 per cent. of Hungarian industrial companies are within the orbit of banks which hold 20 per cent. or more of their capital.

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27. Dispersal of Share Ownership

The evolution of large corporations brought about the necessity of appealing to the general public for funds needed, and this led to a wide dispersal of share ownership. The statement of the Cohen Committee,[2] that "in the last hundred years there has been a great redistribution of wealth so that many small investors have holdings in companies" is undoubtedly true, at least for Great Britain and the U.S.A. How far this movement has gone, and whether it is true, as the Report says,[3] that "this tendency is growing at the present time and the number of shareholders is likely to increase further, with a corresponding diminution of the size of the average shareholding" could be found out only by a detailed examination. Unfortunately no such examination is available, even in Great Britain and the U.S.A., where much

[1] Cf. p. 180. [2] Report, p. 76. [3] *Loc. cit.*

attention has been given to the problem. For Great Britain only scattered particulars are available.

The Cohen Report [1] gives the following figures in respect of ten companies, compiled from the registers of ordinary shareholdings (common stock):

TABLE A

Ordinary Shares of	*Paid-up Capital* (£000)	*Number of Shareholders*	*Proportion of Total Shareholders, each holding* less than 100 *shares*	less than 200 *shares*	less than 500 *shares*
			Per cent.	*Per cent.*	*Per cent.*
Imperial Chemical Industries Ltd.	43,590	124,690	40·4	64·5	86·6
Imperial Tobacco Co. (of Great Britain and Ireland) Ltd..	37,493	94,690	47·4	73·8	90·2
Courtaulds Ltd..	24,000	59,940	43·2	69·0	88·9
Dunlop Rubber Company Ltd.	7,851	52,620	28·4	55·9	81·6
G. and P. Coats Ltd.	14,750	49,570	48·3	75·5	91·6
Unilever Ltd.	11,319	19,420	48·1	75·4	91·8
Fine Cotton Spinners' and Doublers' Association Ltd.	*4,410	17,160	42·4	70·1	89·6
Cunard Steam Ship Company Ltd.	5,570	13,860	27·7	58·6	84·4
Staveley Coal and Iron Co. Ltd.	3,385	6,290	27·8	50·4	76·6
Watney, Combe, Reid and Co. Ltd.	3,185	4,520	25·0	54·0	80·3
Weighted average			41·4	67·5	87·7

* Subsequently reduced.

These figures show that the average holding, if computed by the nominal value of the shares, was relatively small. Thus in the case of Imperial Chemicals it amounted to about £350, and in that of Imperial Tobacco to about £390, reaching in Unilever Ltd. about £580. It is not to be forgotten, however, that the shares of these companies were and still are quoted at prices much above their par value, and consequently the average stake of the holders of their ordinary shares was much higher than these figures show.

The table further shows that, on the average, 41·4 per cent. of the ordinary shares were owned by members holding fewer than 100, 67·5 per cent. by those with less than 200 and 87·7 per cent. by members holding less than 500 shares. If the beneficial ownership of the nominee holdings, which without question exist in every large British company, could be ascertained, the picture would undoubtedly show a lower average holding.

[1] P. 77, based on H. Parkinson: *Scientific Investment* (London, 1932), p. 4.

An analysis prepared by two experts under the direction of Professor P. Sargent Florence,[1] gives particulars of stock ownership in 20 of the 80 largest British trading companies, excluding the 10 analysed by H. Parkinson. The companies were selected at random, and include iron, coal and steel companies, breweries, distilleries and various industrial and commercial undertakings.

The figures given are the total issued capitals, plus (with two exceptions) debentures—if any—and reserves. The analysis of ownership, however, is restricted to the unconditional voting capital, and shows only the 20 largest holdings. Moreover the particulars relate to 1936, and may or may not be valid in 1946.

The proportion of shares held by the twenty largest shareholders varies considerably, the smallest being 4·5 per cent., the largest 79·4 per cent. In the company with the largest concentration of voting power only one-sixth of the issued shares had voting rights; the seven largest shareholders owned 53·5 per cent. of these, so that the company was controlled by the owners of 8·9 per cent. of the issued share capital. In another company members holding 58·3 per cent. of the voting power owned only 7·2 per cent. of the total share capital.

In some companies substantial holdings are owned by other companies. Thus in the company in which 58·3 per cent. of the voting power was held by the 20 largest shareholders, 29·2 per cent. were owned by a bank nominee company, 4·1 per cent. by another nominee company, 0·9 per cent. by a trading company and 2·1 per cent. by two trusts. In another company the corporate holdings amounted to 37·9 per cent., of which 16·2 per cent. were holdings of a bank, 12·9 per cent. of another company, 1·3 per cent. and 0·5 per cent. of two nominee companies, whereas the 20 largest shareholders held altogether 41 per cent.

A detailed and careful analysis for the four British railway companies was made by the *Financial News* in 1944. This was based on the registers of the companies as they stood in August 1944, and beside ordinary shares covers also preferred and debenture stock. Taking all stocks together, the four railway companies had an aggregate stock of £1,108,952,476 with a gross total of stockholdings of 1,137,000. This figure, however, does not indicate the number of persons actually holding stock in these companies.

[1] Read at the meeting of the Royal Statistical Society, November 1946, published in the Society's *Journal* (1947), pp. 2–20.

On the one hand there were duplications within each company, a single person holding more than one class of stock; on the other, it is possible and even likely that some investors held stock in more than one company. The effect of these factors cannot be exactly determined, though it is recorded that in the case of the L.M.S. there were 395,637 holdings but only 323,000 separate accounts, and the register of the L.N.E.R. recorded 402,000 holdings but only 259,468 accounts. For the other two companies there are no data. There are, however, many trustee and nominee holdings, and each of these may be held on behalf of more than one beneficial owner.

In spite of these uncertainties, it is clear that the average holding was just under £1000. The overwhelming majority of the shareholders were owners of small blocks.

Taking all the four railways and all classes of their stocks together—

17·5	per cent. of the holdings did not exceed	£100
34·1	,, ,, ,, ,, ,,	£200
45·6	,, ,, ,, ,, ,,	£300
53·5	,, ,, ,, ,, ,,	£400
63·3	,, ,, ,, ,, ,,	£500
81·8	,, ,, ,, ,, ,,	£1000
97·8	,, ,, ,, ,, ,,	£5000
99·3	,, ,, ,, ,, ,,	£10,000

If we look at the size of the holdings we find that those of £10,000 or more, numbering 8322, represent 24·6 per cent. of the total stock.

The percentage of large holdings is greatest in debentures (31·1 per cent); in ordinary stock it is 22·1 per cent. This difference is due to the fact that debentures, guaranteed and preference stocks were favoured as institutional investments, and in these stocks there were in August 1944 15 holdings of £500,000 to £1,000,000 and eight holdings exceeding £1 million; whereas in ordinary stocks there were only three holdings over £500,000, amounting altogether to £2,167,300, and none exceeding £1 million.

The same journal followed up this investigation by examining the ownership of the London Brick Company [1] and the Cunard Steamship Company.[2] In the former nearly three-fourths of the preference and over four-fifths of the ordinary shareholdings did not exceed £300 nominal value. On the other hand ordinary

[1] 13 April 1945.

[2] 3 May 1945.

shareholdings of £10,000 nominal value and over represented little more than one-quarter of the ordinary stock. In the case of the Cunard Company, holdings in the two preference stocks were widespread to the extent that the number of holdings up to £100 nominal value amounted to 27·8 per cent. of all holdings of the first, and 14·6 per cent. of the second stock, whereas holdings up to £1000 were 91·8 per cent. and 89·7 per cent. respectively. The holdings in ordinary stock up to £100 represented 39·5 per cent., and those up to £1000 94·9 per cent. of all holdings. The holdings from £1001 to £5000, numbering 610, represented 4·4 per cent. of the holdings; there were 50 holdings (0·4 per cent. of the total) between £5000 and £10,000, and 40 (0·3 per cent.) of over £10,000. Holdings between £1000 and £5000 amounted to 7–8 per cent. and 9·5 per cent. of all the holdings. There were none within the £5000–£10,000 range, so that the holdings over £10,000 were 0·4 per cent. and 0·9 per cent. of all the holdings. Unfortunately this computation of holdings is based upon a one-in-ten sample, and is therefore not quite exact.

The analysis of the holdings of £10,000 or more shows that on 7 May 1941 the 14 holdings in the first preference stock represented 16·1 per cent., the 15 in the second preference stock 31·6 per cent. and the 40 in ordinary stock 18·7 per cent. of the respective stocks.

All classes of stock have voting rights, and about 5 per cent. of the ordinary stock is registered in the names of directors. Nominee holdings are relatively small; in ordinary stock they amount to less than 1½ per cent., and institutional holdings represent about 3½ per cent. of the whole of the ordinary stock.

Some particulars have been published by J. F. Ashby,[1] in respect of shareholdings in the "Big Five" for 1933.

Westminster Bank's paid-up capital of £9,320,157 was owned by about 86,000 shareholders[2]; that of the Midland Bank, amounting to £14,248,012, by roughly 75,000.[3] At the same time Lloyds Bank with a capital of £15,810,252 had about 70,000 members,[4] and the National Provincial Bank (capital £9,479,416) 45,000.[5] No data are given in respect of Barclays Bank.

As already mentioned, the real position is obscured by the

[1] *The Story of the Banks* (London, 1934). [2] P. 107.
[3] P. 119. [4] P. 144. [5] P. 167.

existence of nominee holdings and by the fact that in England (unlike Scotland) no trust holding can be recorded as such in the share register. The misgivings caused by a widespread belief that nominee holdings are apt to endanger the national economy by facilitating foreign infiltration into British companies were actually one of the factors which led to the setting-up of the Cohen Committee. Moreover, it was thought that illicit transactions by directors in shares of their own companies might be rendered easier by the use of the nominee device. The particulars supplied to the Committee by the London Clearing Bankers tend to show that the rumours were somewhat exaggerated. It was reported that in 1943 approximately 600,000 individual holdings of debentures, stock and shares in companies were registered in the names of member banks of the British Bankers' Association or their nominees (nominee companies or others). Unfortunately the proportion of such holdings as to either number or size is not ascertainable.

One of the clearing banks gave the following classification of 72,456 holdings in the name of their nominees.

TABLE B

Category	*Total*	*Per cent.*
1. Residents outside U.K.	13,317	18·38
2. Stock Exchange Brokers and Jobbers	6,224	8·59
3. Insurance and Trust Companies	2,798	3·86
4. Security	8,085	11·16
5. (*a*) Facilitation of Stock Exchange purchases and sales (*b*) Convenience due to absence abroad	5,890	8·13
6. As Executors under Wills and Settlements	35,705	49·28
7. Unidentified purposes which might embrace concealment	437	0·60
	72,456	100·00

Although in this case concealment obviously could not have played any substantial part, the possibility of abuses cannot be excluded.

The Companies Act of 1947 [1] gave the Board of Trade wide powers to investigate the beneficial ownership of shares "where it appears to the Board that there is good reason to do so". But it is probable that such investigations will be exceptional. Furthermore there is some basis for the assumption that their results will not in every case be made public, or for that matter

[1] Sec. 46 (1); now sec. 172, Act of 1948.

revealed to the company itself. Thus even if this new instrument were to serve the interests envisaged, it is still doubtful whether it would promote the aim "to enable the shareholder to know who his coadventurers are and the public to find out who controls the business".[1]

Much more material is available in respect of American corporations. The matter was examined in detail by Berle and Means, and subsequently in Monographs Nos. 29 and 30 of the T.N.E.C. The former [2] gave an analysis for the period ending 1929. Of the 200 largest non-financial corporations they examined the stockholder lists of 144. They excluded corporations owned by two or more other companies, and in respect of an unspecified number of corporations they could obtain no information.

Out of the 200 corporations the stocks of only eight were not listed on an organised Stock Exchange or curb market. Of these, four were jointly controlled by corporations whose stocks were listed; the remaining four independent corporations were closely held. Thirty-eight of the 144 corporations were railroads, 37 public utilities and 69 industrials. Twenty corporations (10 railroads, 5 public utilities and 5 industrials) had fewer than 5000 shareholders; 53 (16 railroads, 11 public utilities and 26 industrials) from 5000 to 19,999; 29 (8 railroads, 5 public utilities and 26 industrials) from 20,000 to 49,999; 22 (3 railroads, 10 public utilities and 9 industrials) from 50,000 to 99,999; 7 (1 railroad, 3 public utilities and 3 industrials) from 100,000 to 199,999; and 3 (public utilities) 200,000 or more. No corporation had more than 500,000 stockholders in 1929.

The number of stockholders in the three corporations with the largest gross assets in 1929 was:

American Telephone and Telegraph Co. . . .	469,801
Pennsylvania Railroad Co.	196,119
United States Steel Corporation	120,918

In 1928 Standard Oil of New Jersey had 62,317 stockholders, General Electric 51,882, Union Pacific 47,932, Swift and Co. 47,000, Great Northern 43,741 and Commonwealth Edison 40,000.[3] A survey of 44 companies not included in the largest 200 [4] shows that six reported over 10,000 stockholders and 27 from 500 to 5000.

The total number of stockholdings can only be approximately

[1] Report, s. 77, p. 39.
[2] Pp. 47–68.
[3] Berle and Means, Appendix H.
[4] Appendix G.

estimated. G. C. Means [1] put the number of holdings not of individual shareholders at 18 millions, stating, however, that the actual number may be somewhere between 16 and 20 millions.[2] The number of shareholders is much smaller in view of the numerous duplicate or multiple holdings, and also of the existence of trust holdings. Only the number of those stockholders who reported incomes of $5000 or more, consisting partly of dividends received, is known with some degree of exactness. Their number in 1929 was 597,003, and they received 73·61 per cent. of corporate dividends. It is assumed that approximately 10 per cent. of the dividends were received by persons who filed income tax returns in respect of taxable incomes under $5000 and approximately 16 per cent. by persons who were not liable to Federal income tax. The total number of stockholders can therefore be estimated only within very wide limits, and is thought to lie probably between 5 and 7 millions. The 73·61 per cent. in respect of which the returns give exact information fall into the following classes:

TABLE C

Persons				*Per cent.*
513	with incomes of or over	$1,000,000	dividends received	5·74
14,303	,, ,, ,, ,,	$100,000–1,000,000	,, ,,	24·76
87,762	,, ,, ,, ,,	$25,000– 100,000	,, ,,	48·73
494,425	,, ,, ,, ,,	$5,000– 25,000	,, ,,	24·88

This wide dispersal came about only in the twentieth century.

Table VIII, prepared by Berle and Means,[3] partly based on the researches of H. T. Warshow, estimates that American corporations had—

TABLE D

In 1900	a capital of	$61,831,933,370	and approximately	4,400,000	stockholdings.
,, 1910	,, ,,	$64,053,763,141	,, ,,	7,400,000	,,
,, 1913	,, ,,	$65,038,309,611	,, ,,	7,500,000	,,
,, 1917	,, ,,	$66,584,420,424	,, ,,	8,600,000	,,
,, 1920	,, ,,	$67,205,967,666	,, ,,	12,000,000	,,
,, 1923	,, ,,	$71,479,464,925	,, ,,	14,400,000	,,
,, 1928	,, ,,	$91,881,243,985	,, ,,	18,000,000	,,

The average size of holdings measured at par value declined accordingly. It was—

In 1900	$140·1
,, 1910	$86·3
,, 1913	$87·0
,, 1917	$77·3
,, 1920	$57·3
,, 1923	$49·7
,, 1928	$51·0

[1] *Q.J. of Ec.*, 19, pp. 567–70, and Berle and Means, p. 56.
[2] Berle and Means, p. 372.
[3] P. 56.

Although this classification only shows the movement in respect of stockholdings, a similar trend may be observed in the Income Tax statistics. In 1916 over 57 per cent. of all dividends, excluding those received by other corporations, were received by persons reporting the 25,000 largest incomes, whereas in 1921 this group reported only 35 per cent. of all dividends. In 1916 half the dividends were reported by 15,000 individuals, whereas in 1921 the same proportion covered the dividends of 75,000 persons.[1]

Between 1921 and 1928 the position in respect both of the average size of holdings and of the dividends received was fairly stationary.

In consequence of this wide distribution the largest stockholders of a number of the largest non-financial corporations held in 1929 but a small fraction of the capital of the respective companies. Following Berle and Means,[2] the aggregate holdings of the twenty largest members were:

	Per cent.
In Pennsylvania R.R.	2·7
,, American Telephone and Telegraph Co.	4·0 (in 1928 4·6)
,, United States Steel Corpn. . . .	5·1 (in 1928 6·4, namely, 1·7 in preferred and 8·8 in common stock).

and the largest individual holdings—

In Pennsylvania R.R. Co. . . .	0·34 per cent.
,, American Telephone and Telegraph Co.	0·70 ,,
,, United States Steel Corpn. . . .	0·90 ,,

These authors also give particulars of the size of the largest holdings in the 14 largest corporations.[3] The highest figures for the largest individual holdings in that group were: 2·27 per cent. in Union Pacific Rail Road Co., 2·74 per cent. in Western Union Telephone Co. and 1·5 per cent. in General Electric Co.

An analysis of the holdings in the 200 largest non-financial corporations shows that in only 12 were there no, or at least no important, stockholdings in the hands of the general public. Two of these were railroads, two public utilities. Their gross assets represented about 4 per cent. of the total assets of the 200 corporations. The most important were Ford Motor Co. and three corporations of the Mellon group, namely the Aluminium

[1] Berle and Means, pp. 61–2. [2] P. 47. [3] P. 48.

Co. of America, the Gulf Oil Corpn. of Pennsylvania and Koppers Co. of Delaware.

Ten corporations representing about 2 per cent. of the total assets (1 railroad, 3 public utilities and 6 industrials) could be classified as controlled by majority ownership. The largest industrial corporation of this group was the Singer Manufacturing Co.

Important minority groups could be ascertained in respect of 44 corporations (13 railroads, 17 public utilities and 14 industrials) with assets amounting to about 26 per cent. of the total, whereas in respect of 29 corporations (5 public utilities, 24 industrials) representing, however, only about 6 per cent. of the total assets, the minority interest was thought, though not with certainty, to be in control.

Of the industrial group the most outstanding corporations known to be controlled by large minorities were: General Motors, in which corporation Du Pont de Nemours Co. had a minority interest of about 32·6 per cent.; Du Pont de Nemours, in which the Du Pont family had 30 per cent.; the Standard Oil group, in whose member corporations Rockefeller's interest amounted generally to about 20 per cent., although in Standard Oil of Indiana it was only about 14·5 per cent. There are no particulars as to Standard Oil of California, and the only fact mentioned is that minority interest and the management together control about 55·077 per cent. of the stock, but from Monograph No. 29 of T.N.E.C. we learn that the Rockefeller family held about 12 per cent. of the stock.

In 16 companies (9 railroads, 4 public utilities, 3 industrials) representing 6 per cent. of the total assets, other corporations held important blocks, varying from 25 to 50 per cent.

In respect of 86 corporations representing 56 per cent. of the total assets it may be said that ownership was widely distributed and there were no important minority blocks, at least none that influenced the control of the corporation concerned.[1]

This wide dispersal of stock ownership is undoubtedly connected with the evolution of the giant corporation. As the size of a corporation grew, it became more and more difficult for the holder or holders of the stock to provide of themselves the funds required for enlarging the enterprise and securing an adequate working capital; all the more as self-financing out of profits was possible only in exceptional cases, and additional

[1] Cf. Berle and Means, pp. 47–68, 91–118; Appendices G–K, pp. 367–74.

funds could be secured in most cases only by an appeal to the public and by placing the additional stock on a wide scale.

In order to secure control for the diminishing proportion of stock retained, special legal devices were sought and found (cf. § 29).

An important factor was the incidence of taxation, especially the introduction of a progressive income tax. For individuals in the higher scales it became increasingly difficult to save substantial parts of their income and thus to accumulate sufficient means to invest in additional issues of stock, whereas in case of death the payment of death duties often led to a partial liquidation of holdings. Lastly there were cases in which the owners of majority or important minority stock availed themselves of favourable prices to sell a part of it in order to invest the proceeds in other enterprises—real estate, art collections and so on.

As we have said above, two important publications of T.N.E.C. relate to the distribution of stock ownership. Monograph 30 gives a survey of shareholdings in 1710 corporations, whose securities were listed on one or more of the national securities exchanges, while Monograph 29 gives an analysis of the stockholdings in the 200 largest non-financial corporations. Both relate to the position at the end of 1937 and have the advantage of being based upon the returns filed with the S.E.C. These two monographs furnish ample material for further research. We have, however, to restrict ourselves to a summary of those results which seem essential for the purposes of this book, and cannot discuss the methods of computation and estimate used.

First it is to be borne in mind that these two publications cover merely a part, although a substantial part, of U.S.A. corporations. The 1710 corporations dealt with in Monograph 30 include financial and investment companies; commercial banks and insurance companies are practically unrepresented, whereas Monograph 29 (like the analysis of Berle and Means) excludes all financial corporations.

The assets of the 1710 corporations amounted to $103 millions, those of the largest 200 non-financial corporations to about $70 millions. The total of the assets of all American corporations was at the same time (end of 1937) $303,157,000. The monographs estimate that the assets of the former group represented about 40 per cent. of the assets of all corporations, if commercial banks and insurance companies are excluded, and

those of the latter slightly over 40 per cent. of the assets of all non-financial corporations.[1]

Of the total number of shareholdings in American corporations no exact figures are available. The estimate is that there were roughly 26 millions at the end of 1937 (the smallest estimate is 24,500,000, the highest 27,500,000). These numbers show an increase of about 8 millions since 1928, the total par value of stocks being about the same. Of these 26 million stockholdings about 21 millions were in common and 5 millions in preferred stock, and it was estimated that somewhat less than one million were holdings of indigenous corporations, non-profit-making organisations and foreign stockholders, and about 25 millions holdings of indigenous individuals. It is stated on the other hand that approximately 35 per cent. of the stock was owned by other indigenous corporations, including personal holding companies, about 1 per cent. by non-profit-making institutions, and between 2 and 3 per cent. by foreigners; about 50 per cent. was directly owned by indigenous individuals and 10 per cent. by estates and trusts, whereas out of this 60 per cent. 10 per cent. was registered in the names of brokers.

According to Monograph 30,[2] there were in the 1710 corporations almost 14 million recorded shareholdings, about 11,500,000 in common and about 2,500,000 in preferred stockholdings in respect of 2381 common and preferred stock issues covered by the study. On the other hand the number of recorded shareholdings in the 200 largest non-financial corporations at the same time (end of 1937) was 8,500,000, of which 7,027,000 were in common and 1,394,000 in preferred stock.

The number of beneficial exceeded that of recorded shareholdings. The 14 million recorded shareholdings in the 1710 corporations were estimated to represent about 16 million beneficial shareholdings.

The number of persons holding stocks in at least one corporation was considerably smaller. It was not possible to give more than approximate estimates of the actual number of shareholders. As to the overall number of shareholders Monograph 29 comes to the conclusion that at the end of 1937 there were probably between 8 and 9 millions. Earlier rough approximations were considerably higher, and Monograph 29 admits that the number may have been as low as 7 or as high as 10 millions.

[1] Mon. 29, p. 23; Mon. 30, p. V. [2] P. 7.

On the basis of this estimate it is assumed that on the average every stockholder held shares in about 2½ corporations and three different issues.[1] In respect of the 1710 corporations with securities listed on the national stock exchanges the estimated number is about 5 millions, and that in the 200 largest non-financial corporations about 3 millions.

The number of 8–9 million stockholders estimated for 1937 shows a considerable increase as compared with 1927, when the number of shareholders was held to be between 4 and 6 millions.

The average estimated value of individual shareholdings in the 1710 corporations was about $3000. For the largest 200 non-financial corporations a division of the aggregate value of the securities issued by them (33 million dollars) by the number of recorded holdings would give an average of about $3900.

An overall estimate of the average value of stock held by one individual is hardly possible, since the overwhelming majority of corporations had no stock issues quoted on a stock exchange. Should we base such an estimate upon the nominal value of the stock of corporations which filed balance sheets, assuming that the stock owned by other corporations is owned ultimately by indigenous individuals, we should arrive at an estimate of 95,703,400,000 dollars as the amount of the total capitalisation in common and preferred stock at the end of 1937. If we deduct the estimated holdings of non-profit-making institutions (1 per cent.) and of foreign stockholders (3 per cent.), the average par value of the holding of one individual would have been over $10,000.

Monograph 29 bases its estimate on the dividends paid in 1937 to indigenous individuals and fiduciaries. These dividends amounted to something over 4,500,000 dollars. The average dividend income was therefore slightly over $500, corresponding to a market value of about $10,000 for the year, which declined by the end of 1937 to an estimated value of about $7000.

The average of stock held by indigenous individuals, however, reveals very little as to its actual dispersal and degree of concentration. A sample of 5000 Federal income tax returns for 1906 showed that persons reporting less than $5000 income received dividends on the average from 2–4 corporations; persons with incomes from $10,000 to $15,000 from 13, and those with incomes of $100,000 or more from 25 dividend-paying corporations.

[1] Mon. 29, pp. 10–12.

As to the distribution of dividends, in 1937 probably about half the stockholders received less than $100 in dividends, and not more than some 2 million more than $500. Not many more than 100,000 stockholders had a dividend income larger than $5000, and fewer than 10,000 individuals a dividend income of over $50,000.

The percentage of the total dividend income received in 1937 was as follows:

The largest	1000	recipients	received	10·4	per cent.	of the	total.
,, ,,	10,000	,,	,,	37·6	,,	,,	,,
,, ,,	61,000	,,	,,	50·0	,,	,,	,,
,, ,,	100,000	,,	,,	57·6	,,	,,	,,

Of the trend in dispersal for the period before 1927 only private estimates are available. These suggest that there was a considerable shift from larger to smaller ownership in the years 1916–21, with little change between 1922 and 1927. In the years 1928–37 there was undoubtedly a considerable increase in dispersal.

The estimated number of indigenous stockholders at the beginning of this period was 4–6 millions, and in 1937 8–9 millions, whereas the aggregate nominal capital amounted in 1927 to $91,881 millions, consisting of $17,800 millions of preferred and $74,081 millions of common stock. It rose at the end of 1937 to $95,731 millions—$18,475 millions in preferred and $77,256 millions in common stock. The increase in the number of stockholders was therefore largely due to a shift in ownership and only to a less extent to the taking up of additional shares.

This trend likewise is revealed in the percentage of dividend receipts; in all the four classes mentioned there was a decline, since in 1927 the—

1000	largest	recipients	received	12·5	per cent.	of the	total.
10,000	,,	,,	,,	43·5	,,	,,	,,
100,000	,,	,,	,,	66·0	,,	,,	,,

and 38,000 were in receipt of 50 per cent. of all dividends.

Even so the concentration of stock ownership and dividend income is higher than that in the total income, and Monograph 29 regards the difference between 1927 and 1937 as not very substantial. We are further told that the diminution of concentration occurred in the first part of the period, between 1927 and 1937, and that in the second part there is some evidence of a slight reversal of this tendency.

This trend appears also in the number of stockholdings

recorded by Berle and Means as representative for the class of the 200 largest non-financial corporations.

Pennsylvania Railroad	in 1928	recorded	157,650	stockholdings.
,, ,,	,, 1937	,,	215,000	,,
American Telephone and Telegraph Co	,, 1928	,,	454,596	,,
,, ,, ,, ,, ,,	,, 1937	,,	641,308	,,
United States Steel Co.	,, 1928	,,	100,784	,,
,, ,, ,, ,,	,, 1937	,,	167,740	,,

In all three corporations the peak was reached in 1931, in which year the numbers were 241,391, 642,180 and 174,507 respectively.

It would be of great interest to know whether and how far dispersal has been extending or receding since 1937. Unfortunately no comprehensive data are so far available. The scattered information which the author has been able to collect tends to show that dispersal made further, though in some cases slow, progress. It is reported that at the end of 1944 American Telephone and Telegraph Co. had 668,000 recorded shareholders, an increase of not more than 4 per cent. General Motors in 1929 recorded 189,600; in 1937, 363,005; and in 1944, 426,000 stockholders. Swift and Co. in 1929 had 47,000, in 1937 57,081 and in 1944 60,000. Borden and Co. in 1929 had 17,167, in 1937 47,595, and in 1944 49,000 stockholders on record.

It is of some interest to compare the lists of the 20 largest stockholdings in some of the largest non-financial corporations as recorded for 1929 and 1937. In Pennsylvania Railroad the 20 largest stockholders held in 1927 2·70 per cent. of the stock; in 1937 6·25 per cent. In American Telephone and Telegraph in 1928 the 20 largest stockholders represented 4·6 per cent. of the stock, in 1937 3·82 per cent. In the case of the United States Steel Co. 6·4 per cent. are reported for 1928 (1·7 per cent. for preferred and 8·8 per cent. for common stock); for 1937 11·46 per cent. (14·73 per cent. preferred and 12·4 per cent. common stock).

These figures if considered only numerically would show in two of these companies a vast increase of concentration. But a fundamental change is to be observed in the structure of these largest stockholdings. In 1928 and 1929 the holdings of individuals were prevalent, but in 1937 they shrank considerably. In the case of the Pennsylvania Railroad Co. 1·64 per cent. out of the 2·7 per cent. were held by insurance companies, investment trusts, banks and brokers, and 1·06 per cent. by individuals; in 1937 only one individual shareholder was recorded with a holding

of 0·15 per cent. out of the 6·25 per cent. In the American Telephone and Telegraph Co. the range of the 20 largest individual holdings declined from 1·36 per cent. in 1928 to 0·31 per cent. in 1937. In the case of the United States Steel Corp. individuals were recorded in 1928 as owners of 2·11 per cent. of the stock, and the remainder of the largest holdings, amounting to 4·29 per cent. of the stock, were in the name of partnerships; among the 20 largest stockholders not one corporation was found. In 1937, however, individual shareholders on record represented only 1·80 per cent. of the common and 0·93 per cent. of the preferred stock, the rest being held by investment trusts, insurance companies, bankers and brokers; one investment trust held 3·71 per cent. of the common and six insurance companies 11·39 per cent. of the preferred stock.

While in many of the 200 largest non-financial corporations stock ownership was widely dispersed, there were still corporations in which the majority of the voting stock was closely held. Monograph 29 reports three corporations the whole of whose voting stock was held by one family, directly in the Ford Motor Co. and indirectly through a holding company device in the Great Atlantic and Pacific Tea Co. of America and Hearst Consolidated Publications Inc. In five corporations the majority of the common stock was owned by the members of a single family, whereas in a number of other corporations the majority of the common stock was controlled by multi-family interests.

According to the findings of T.N.E.C., all the three family concerns discussed by Berle and Means, i.e. the Rockefeller, Mellon and Du Pont families, retained their position. The Rockefeller family, beside its substantial minority holdings in the six oil companies of the Standard Oil group, has a similar holding in the Chase National Bank. The Mellon family at the end of 1937 held about 70 per cent. of the Gulf Oil Co., 52 per cent. of the common and 82 per cent. of the preferred stock of Koppers United Co. (coke and coal), 50·1 per cent. of the common and 33·9 per cent. of the preferred stock of the Aluminium Co. of America. Their other interests included rails, banks and public utilities. The Du Pont family had the same substantial minority interests in industrial corporations and in banks as in 1928. The most important was that in E. J. Du Pont de Nemours Co., amounting to 43·9 per cent. of the common stock of this giant chemical concern, whereas the

corporation holds 19·78 per cent. of the common stock of General Motors. Further important holdings are reported in United States Rubber Co., where the holdings of the Du Pont family amounted to 11·51 per cent. The same family also had a substantial interest in banking. Relatively important minority holdings were found in a number of other corporations belonging to the group of the 200. In about 60 of the 200 corporations other corporations held substantial blocks, which in 30 of them reached or exceeded 50 per cent.

Returning to the overall picture, in 1937 about 6 to 7 per cent. of the inhabitants of the U.S.A. owned corporate stock, and somewhat less than 20 per cent. of the income recipients received dividends. The dividends represented about 7 per cent. of aggregate income, but they amounted to over 16 per cent. of the total income of those who filed Federal income tax returns.

The average dividend income of the 8–9 million persons reputed to have been stockholders in 1937 amounted to about $500. Only about 2 million persons received a dividend income in excess of this sum; there were not many more than 100,000 stockholders with a dividend income exceeding $5000, and fewer than 10,000 individual stockholders received over $50,000.

In spite of the degree of concentration shown by the particulars collected as to the dispersal of ownership and the data of income tax statistics, it is obvious that a fairly large public interest in stock ownership is existent, which needs and fully deserves effective protection by law. This applies especially to the small investor who has neither the time nor the means to defend his interests against exploitation. It is for the legislature to decide whether concentration shall be preferred, and corporate enterprise become increasingly a privilege of the few, or whether it shall be made safe for the little man with restricted resources. It is the latter alternative which is advocated in this book, and to this end the strengthening of the existing legal safeguards is indispensable.

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28. Management and Control

The business of a partnership is generally managed by the partners, who may employ agents. A corporation, however, can only be managed by agents.

In the era of chartered companies, as we saw in Chap. I, the charter always provided for the appointment of agents and regulated their powers. Subsequently the general Companies Acts imposed on the companies the obligation to appoint agents, usually called directors, and regulated their powers and the procedure.

The election of the directors belongs to the shareholders in general meeting, though some legislations empower the founders to appoint the first directors for a limited period. The shareholders generally also have power to remove them by a resolution in general meeting, but this power in some countries is limited.

The power to manage the company's affairs is vested in the directors. Some legislations are satisfied with one director, others require several and fix a minimum number. Where there are several they have as a rule to act as a board.

The settlement of certain fundamental matters is reserved to the shareholders in general meeting, but the various company legislations differ as to the delegation to the directors of powers which otherwise would remain reserved to the general meeting. The most liberal view in this matter is taken by the U.S.A. laws (cf. § 79, Vol. II), in consequence of which in the ordinary life of a corporation the power of the shareholders in general meeting is confined to the election of directors. "Within the limits prescribed by law" all powers directly conferred by statute or impliedly granted, must of necessity be exercised by the directors, who are constituted by the law as the agency for the doing of corporate acts. In the management of the affairs of the corporation they are dependent solely upon their own knowledge of the business and their own judgment as to "what its interests require".[1]

The rule that the directors have the power to manage the affairs of the company means that a contract, in order to be binding, must be made by them, and the shareholders cannot act on the company's behalf. In so far as the directors act within their powers as defined by law or the articles, they need

[1] Beveridge *v.* New York Elevated R.R. Co., 112 N.Y. 1.

no special authorisation, and as a rule the general meeting cannot by resolution override their powers. This is the view taken by the Anglo-American law (see § 79, Vol. II). It is sometimes held, however, that where the shareholders unanimously resolve that a certain act should be performed, this should control the discretion of the directors.[1]

The laws of the European Continent generally provide that the directors must comply with instructions given by the general meeting, even in the case of a resolution carried by majority vote only, but the violation of such a resolution does not affect the validity of a transaction. The trend in actual practice is to secure for the directors the dominating role in the company's affairs, and the wording of the articles in most cases aims at enlarging and not at restricting their powers. Furthermore, shareholders as a rule take no active interest in the company's affairs. Resolutions instructing directors to pursue or to refrain from some line of action are seldom moved, and even more seldom carried.

It is everywhere either expressly provided by Company Law or recognised by the Courts that directors who neglect their duties through non-feasance or mis-feasance are responsible, but a general meeting would but seldom adopt a resolution to sue directors for damages. Individual shareholders are not everywhere entitled to bring representative actions on behalf of the company, and where such actions are admitted, the burden of costs is usually a deterrent.

The removal of directors is never an easy matter, and in many countries either by law or by the articles it is made to depend on certain conditions, such as a special resolution or a specific majority, with which compliance is difficult. The directors are usually in a position to make use of proxies to counter any attempt to remove them, and strong action and large resources are necessary for such a campaign to succeed. These difficulties are harder still to overcome in the case of large corporations, and only a few cases are known in which directors of such corporations have been ousted.

How hard the fight to unseat a board in possession may be is illustrated by the conflict in Standard Oil of Indiana, in which at the time the Rockefeller Group had a holding of 14·9 per cent. Mr. John D. Rockefeller Jr. was dissatisfied with the management

[1] Cf. Ballantine, s. 43.

of Colonel Stewart, chairman of the board, in consequence of his part in certain dubious transactions, and in 1929 asked for his resignation. Colonel Stewart refused to resign, and was supported by the board. In the ensuing struggle the board denied Mr. Rockefeller the use of the proxy machinery, sought the support of the 16,000 odd employee stockholders, and in order to impress the members, declared a 50 per cent. stock dividend. At the meeting the Rockefeller Group obtained the votes of 5,519,210 shares against 2,954,986 for Colonel Stewart and the board, i.e. about 59 per cent. of all the votes, with only 870,492 shares, or less than 10 per cent., abstaining.

This sounds an outstanding victory, but was undoubtedly due to the substantial holding of the Rockefeller Group, its prestige, and the serious grounds for a change in management. The effort is said to have cost the Rockefeller Group $300,000.[1] It must also be borne in mind that in this case there was only one class of stock with equal voting rights, and none of the usual legal devices for artificial control by a minority existed. By using such devices the existing management may be able to make its position practically unassailable.

These legal devices will be discussed in detail in connection with the subject of voting rights (§ 71, Vol. II). The first is the issue of preferred stock (preference shares) with contingent votes, i.e. votes exercisable only if the dividends remain unpaid over a certain time. This device is widely used in Great Britain and the U.S.A., and on the whole is not much criticised. In such a case control of the common (ordinary) stock means control of the company.

A more recent and objectionable device is the issue of non-voting common stock. This came into use in the U.S.A. in the 1920s. In one case (Dodge Brothers Inc.) only one-fifth of the common stock had votes in the election of directors. Since the corporation had also a large issue of non-voting preferred stock, the holders of the privileged common stock were able to control the corporation by an investment of about 2 per cent.

The American Cyanid Co. in June 1938 had 65,943 voting and 2,498,957 Class B non-voting common shares, and 170,453 preferred shares with contingent voting rights, about 2½ per cent. of the stock having absolute control.

Another means is the issue of shares with unequal voting

[1] Berle and Means, pp. 53–54, Monograph 11 of T.N.E.C., p. 20.

rights. This device was widely used in Germany in the form of preference shares with limited participation in dividends and distribution in case of winding-up (see §§ 21 and 23). There were similar cases in the U.S.A. also. Thus the Cities Service Company, a large public utility concern, issued in 1929 one million dollars in preferred shares of par value $1 to H. L. Doherty and Co. Each such share gave one vote in the election of directors, whereas only 20 common shares had one vote. The ownership of the stock was widely dispersed, 81,470 holdings of preferred and 377,988 of common stock being on record on 15 June 1930.[1] No wonder that according to T.N.E.C.[2] in 1937 the Doherty family was in control with a holding of 5·05 per cent. common stock.

A most effective plan is the use of holding companies, by which a minority interest may acquire and maintain control even without any legal device. If, for example, a holding company is created to acquire and hold 51 per cent. of the stock, and that company sells from its capital 49 per cent. to the general public, approximately 26 per cent. of the original investment is needed for control. The position is more favourable for the controlling group if the 49 per cent. of the holding company's stock may be sold at an enhanced price, which is possible in times of booms and in fact has frequently occurred. By means of pyramiding, i.e. the forming of a second holding company on similar lines, coupled with issues of non-voting stock, it became possible with relatively insignificant investments to control one or several large corporations. In some cases the position was made even more complex by the use of one or more holding companies to acquire and hold stocks of other member companies of the same group, so that an outsider was unable to get a clear view of the real position. An outstanding example of pyramiding in respect of railways was the Van Sweringen concern, in which "system as a whole less than 1 per cent. of the ownership represented combined ownership and control".[3]

This device was extensively used in the public utility field. In the notorious Insull system "at one time Insull interests controlled some of the bottom companies with as little as two hundredth of one per cent ownership of the securities of those companies. Yet at only one step of the many-tiered pyramid did

[1] Berle and Means, p. 76. [2] Monograph 29, pp. 113 and 1491.
[3] Berle and Means, p. 73.

Insull have less than a majority of the voting stock of the holding or operating company".[1]

The building up of such pyramidal systems was abused to conceal the real state of things and the financial results of the operating companies by way of inter-corporation contracts in order to manipulate the markets in the securities concerned and to induce the ignorant public to purchase them at inflated prices. The great slump of course hit these concerns most severely, and several of these pyramids collapsed. As the abuses came to light, public opinion demanded remedies, and under its pressure Congress in 1935 adopted the Public Utility Holding Company Act. This Act gave the Securities and Exchange Commission wide powers to bar transactions of this kind for the future and also to reduce the existing artificial structures (cf. § 22).

Another way of depriving stockholders of their controlling influence is the formation of voting trusts and the issue of voting trust certificates (see § 74, Vol. II).

Even in the absence of any such device the board is in most cases in a position to obtain proxies from the holders of voting shares in sufficient numbers to dominate general meetings. The management, together with the invitation, forwards a form containing a list of persons who will undertake to act as proxies, in the U.S.A. often called the "proxy committee". If the shareholders react at all, they sign the proxy form, and in this way the management may maintain its power. It has been truly said that "the existing dominant group in the typical large corporation must sin greatly before the judgment of the majority breaks around its head".[2]

How successfully an existing board may defeat opposition was shown in the case of the Tide Water Association Oil Co. Here a shareholder had apparent control of about 35 per cent. of the stock, but nevertheless was unable to make the directors more responsive to the shareholders and lost the battle for proxies.

On the other hand the board may give way to a small minority and resign in case of gross mismanagement.

To appreciate the relation between management and shareholders, the change which has taken place in the structure of the former must be considered. In earlier times the affairs of

[1] T.N.E.C. Monograph 11, p. 19, quoting Federal Trading Commission Utility Corporations No. 72A (1935), p. 160.

[2] T.N.E.C. Monograph 11, p. 19.

companies were actually managed by the directors. They met frequently, discussed even minor current affairs, and made decisions on the conduct of the regular business. They had, of course, to appoint salaried employees for technical and administrative duties, but on the whole the management remained in their hands.

With the growth in the size of corporate units, and particularly the combination of manifold activities, the increased variety of the forms of production and of business operations, this became increasingly difficult. The boards had to appoint salaried officers and managers for the conduct of day-to-day business, and retained in their own hands merely the settlement of general business policy, decisions on important matters and the supervision of the management. Within the giant corporations even this became difficult, and a large part of the board's business had to be entrusted to special committees.

Whereas a director has always been fully entitled to carry on business or professional activities outside the company, the duties of an executive officer or manager are always a full-time job. He has to devote all his skill and ability to the company, and is entitled to carry on outside activities only by special permission. In Great Britain managers may at the same time be members of the board of directors (managing directors), and similarly in the U.S.A. the executive officers, usually called president and vice-president, may be members of the board (officer-directors). The same is the case in many other countries. In Germany, however (see §§ 15, 21), the management (*Vorstand*) was strictly separated from the board. The board, called the council of supervision, did not, in fact, fulfil that function at all and in many companies was considered a mere formality. Its functions were to settle business policy, decide on matters of principle and act as intermediary between the management and the general meeting. The ultimate power in many companies became concentrated in the management. Even in the absence of any such regulation, the larger the company, the more complex and manifold its business, the greater the influence of the executives, whether they are at the same time directors or not; and there is nowadays a tendency both in Great Britain and in the U.S.A. to look with disfavour on directors who are not executives. This matter is discussed in § 79, Vol. II, and here it is sufficient to point out that in the author's opinion a non-executive director, particularly if he has some standing in the business or professional community,

may still be able to fulfil a useful function in assisting the executives by giving them the benefit of his experience in affairs outside the company.

The appointment and remuneration of the officers (managers, representatives) is within the competence of the board of directors. This is indeed one of the board's most important functions, especially if the appointment is for a term of years, as is usual in Britain and on the Continent, though not in the U.S.A.

The remuneration of the executives generally consists of a salary fixed by agreement, with in most countries a percentage of net profits or some sort of commission, whereas in the U.S.A. the executives receive bonuses which are, or should be, proportionate to the year's profits. The bonuses are in most cases fixed by the board, though instances are known in which arrangements have been made similar to those in Great Britain and Europe.

In Great Britain the directors, if not executives, receive as a rule annual fees fixed by the articles or by the general meeting. On the European Continent this remuneration usually takes the form of a percentage on profits, though in some cases directors receive annual fees or both. In the U.S.A. it is not usual to pay non-executive directors more than nominal fees.

Generally directors nowhere have a claim to remuneration unless the articles or the general meeting authorise fees, and the prevailing opinion is that directors have no power to fix fees for themselves without such authorisation. Furthermore the trend of public opinion is that shareholders and the general public should be informed regarding the fees and emoluments of directors and executives; but this is not everywhere safeguarded by law.

Directorships are much sought after even in the absence of fees. The reason is often an interest in the company in consequence of shareholdings, which are either personal, or belong to a person or group whose interests are to be safeguarded. Officers or directors of insurance companies frequently have seats on boards by reason of the shareholdings of their companies. Purely financial interests may also play a part. Officers and directors of banks are often directors of companies which are debtors or customers of their bank. Indirect advantages may also be gained, such as the possibility of patronage or the obtaining of inside information. The use of inside information for private purposes is a most objectionable abuse, and under some legislations has given rise to restrictions and remedies (cf. § 82, Vol. II).

Another question is how far such aspirations are successful. The existing boards always tend to resist intrusions and to apply a careful scrutiny to candidates, and will consider whether the holding or some other reason justifies a demand for representation on the board. In many cases, however, an invitation to join comes from the board itself, either in order to strengthen its position by including holders of substantial amounts of stock, or to utilise expert knowledge in trade, finance or production. Candidates of reputed influence and in good relations with the government, such as cabinet ministers out of office, retired government officials and generals and admirals on half-pay, are often elected to the boards of large companies. Political patronage also plays some part, and in many cases persons have been added to the boards of companies, especially those of lesser standing, merely because of their high-sounding names. In Germany and other European countries many posts were filled by delegates of the big banks, and consequently, as we have seen, certain persons, e.g. bank managers, occupied simultaneously so many seats on boards that the law had to intervene.

How many directorates a single person may successfully occupy depends upon circumstances, but it is undoubtedly in the interest of the effective functioning of the boards that there should be no multiplication of offices.

An inquiry made for Great Britain under the supervision of Professor P. Sargent Florence shows [1] that, in the 20 trading companies investigated, the 20 largest stockholders represented only in two cases a majority on the board of directors. In two companies, however, none of them held office; in the remaining companies they were in a minority, only in one case slightly exceeding 33 per cent.

A sample of 315 companies shows that the share qualification required of directors was in 61 companies under 0·2 per cent.; in 46 companies from 0·2 to 0·4 per cent.; 88 companies required 0·4 to 1 per cent.; 111 from 1 to 5 per cent. and 9 companies 5 per cent. or more. The proportion of qualifying shareholdings was much less in larger companies. Of 84 companies with a capital exceeding £500,000, only 7 required a holding of from 1 to 5 per cent.; 23 between 0·4 and 1 per cent.; 20 from 0·2 to 0·4 per cent. and 34 under 0·2 per cent.

[1] *Journal of the Royal Statistical Society* (1947), pp. 12–17. The particulars are for 1936.

An earlier investigation [1] shows that of 15 large British companies only two required from the board a holding of more than 0·4 per cent., and for other large companies it was found [2] that the qualification required exceeded 0·4 per cent. only in two companies, and in none of them attained 0·5 per cent.

Professor Florence found [3] that on the boards of 436 British trading companies there were 127 accountants, 58 lawyers and 88 individuals with some technical qualification, and that the ratio of accountants and technicians increased with the size of the company. In companies with a capital of over £500,000 technicians numbered 4·7 per cent. and accountants 5 per cent. of the number of directors. On the other hand 172 directors, roughly 8 per cent., were noble or titled persons, and in companies with a capital over £500,000, titled persons held about 15 per cent. of all directorships, about half of them having inherited titles or titles acquired in other fields than business.

A survey of 2157 directorships in a number of sample companies shows that 910 directors (42 per cent.) held only one directorship; 547 (26 per cent.) two or three; 306 (14 per cent.) four or five; 258 (12 per cent.) six to ten; and 136 (6 per cent.) over ten. In companies with a capital over £500,000, multiplication is considerably more frequent. Of 623 directors 81 (13 per cent.) held more than ten directorships; 105 (17 per cent.) from six to ten; 118 (19 per cent.) from four to five; 163 (26 per cent). from two to three; and 156 (25 per cent.) only one. How far multiplication is due to the fact that directors of holding companies usually sit on the boards of their subsidiaries has not been ascertained.

The investigation of the National Resources Committee [4] shows that in the 200 largest non-financial, and the 50 largest financial corporations of the U.S.A. 2722 individuals held 3544 directorships, distributed as follows:

1	director	held	9	directorships	
3	directors	,,	8	,,	each
6	,,	,,	7	,,	,,
6	,,	,,	6	,,	,,
19	,,	,,	5	,,	,,
48	,,	,,	4	,,	,,
102	,,	,,	3	,,	,,
303	,,	,,	2	,,	,,

[1] H. Parkinson, *Scientific Investment*, p. 141.

[2] Miller and Campbell, *Financial Democracy*, p. 85.

[3] P. Sargent Florence, *Logic of Industrial Organisations* (1933), pp. 204–20; *J. of R. Stat. Soc.* (1947), pp. 13–14.

[4] *The Structure of American Economy* (Washington, 1935), I, p. 158.

This is a far smaller degree of multiplication than that observed in Germany, where the law of 1939 introduced a legal maximum of ten boards, though the government might grant exemptions.

An analysis of the question how and on what grounds seats on boards of directors are filled is in our view of great public interest. Unfortunately little has been done in this field outside the U.S.A., and even there the investigation has been mainly concerned with the concentration of economic power and consequently with the size and percentage of the stockholding interests of the management. We learn that as on 30 September 1939 about 2500 officers and directors reported 3511 holdings of stock in the 200 largest non-financial corporations; there were, however, about 500 directors, director-officers and officers without any holdings in their own corporations. The total value of management holdings was about $2,163,000,000, i.e. about 5·5 per cent. of the total, of which 3·5 per cent. represented the holdings of directors and 1·9 per cent. holdings of officer-directors, whereas officers held only 0·1 per cent. of stock. The percentage was about 6 per cent. of the total common, and 2·2 per cent. of the total preference stock, whereas comparing the respective size and value of these two classes of stock, the holdings in preferred stock represented only 4·7 per cent. of the total number of shares held by the management and 5·5 per cent. of their market value. Of the holdings in common stock 73 per cent. fell to holdings in voting, and 27 per cent. to non-voting common stock. But if the exceptionally large holdings of non-voting common stock in the two closely held companies, the Ford Motor Co. and the Great Atlantic and Pacific Tea Co., are excluded, the percentage of voting common stock is considerably larger.

The picture given by these figures is much obscured by the fact that in certain corporations the holders of the majority or of important minorities are represented on the boards: thus with the Ford family in Ford Motor Co., members of the Du Pont family on the boards of E. J. Du Pont de Nemours Co. and of the General Motors Co., members of the Mellon family on the boards of Gulf Oil Co. and Aluminium Co. of America, and so on. Where the members of the dominant group are not on the board, the holdings of directors and officers are very small. This is the case in the Standard Oil group, where no member of the Rockefeller family occupies a seat on the board and the holdings of directors and officers amount to 0·27 per cent. in Standard

Oil of New Jersey, 0·24 per cent. in Standard Oil of Indiana and 0·19 per cent. in Standard Oil of California.

The holdings of directors and officers were lowest in railways, communications and public utility companies: they amounted to 3 per cent. of the total holdings of directors and officers. About 75 per cent. were in manufacturing industries and 13 per cent. in merchandising corporations.

To quote some examples: the holdings of directors and officers in Pennsylvania Railroad Co. amounted to 0·11 per cent., in American Telephone and Telegraph Co. to 0·04 per cent. of the common and in United States Steel Co. to 0·21 per cent. of the common voting and 0·14 per cent. of the preferred voting stock. In the public utility field the holdings were: in Commonwealth and Southern Co., 0·72 per cent. of voting common and 0·05 per cent. of preferred voting stock; in Consolidated Edison Co. of New York 0·19 per cent. of voting common and little more than 1 per thousand of preferred voting stock. Thus in the management-controlled corporations the holdings of officers and directors were relatively very small.

There is evidence of the far-reaching influence of certain financial groups over corporations which appears *inter alia* in the membership of the boards. It is reported that in 1933 the partners of J. P. Morgan and Co. held 167 directorships in 89 corporations, of which 15 were banks and trust companies, 7 miscellaneous holding companies, 10 railroads, 5 public utility holding and 8 operating companies, 38 industrial and 6 insurance companies.[1]

The National Resources Committee reported for 1935 that the interest group of the Morgan and the associated First National Bank of New York included corporations with assets amounting to $30,210,000,000, of which assets of industrials were $3,920,000,000, rails $9,678,000,000, banks $442,100,000 and public utilities $12,191,000,000. A smaller but still large financial group was that of the New York bankers Kuhn, Loeb and Co., focussed mainly on railroads with assets amounting to $9,903,000,000. Similar though much smaller groups were those of the First National Bank of Boston, including corporations with assets of $1,719,000,000, the allied group of the Continental Illinois National Bank and Trust and the First National Bank of Chicago, with assets of $4,266,000,000, and lastly the group of the Cleveland

[1] Gunther, *Inside U.S.A.*, p. 571.

Trust Co. with assets of $1,404,000,000. None of these three groups had any interest in rails, nor had the Cleveland group any interest in public utilities.

Owing to the existence of these financial centres of influence, and to the ramifications of the Rockefeller, Mellon and Du Pont groups and a large number of intercorporate holdings, there are many interlocking directorates. The National Resources Committee [1] reports that only 25 of the 200 largest non-financial, and 50 of the largest financial corporations had no interlocks, i.e. common directors, whereas 157 had interlocks with three or more corporations, and these corporations owned nearly 75 per cent. of the assets. There were 10 corporations interlocked with 26 others.

There are some defenders of interlocking directorates. The participation of directors of other corporations is said to do no harm, since they are inactive or belong to minority groups without influence. It has even been argued that under certain circumstances directors who are directors or executives of other corporations may give valuable advice and assistance. But it is obvious that directors whose main interests are in other concerns may use their position on a board to foster those interests. Thus the officer or director of a bank may try to secure a company's banking transactions for his bank; a manager of an insurance company the insurance contracts, and so on. Experience shows that this has actually been done in many cases, and that interlocking is not without dangers. Several Federal and State Acts prohibit interlocking directorates in respect of certain classes of corporations, and in some cases a contract made with participation of common directors may be voided.

The stake of all executives, i.e. officers and officer-directors, is, as we have seen, small in their companies, and their income is derived mainly not from dividends but from salaries, bonuses and other emoluments, originating from their offices.

Although it is unusual in the U.S.A. for executives to have contracts stipulating percentages on the profits, the bonuses fixed are more or less connected with the results of their management and are a strong stimulus to their efforts. It is nowadays popular to stress that other motives, such as prestige and loyalty to the enterprise, play a very important part—sometimes equal to or even stronger than financial interest. This is certainly to some

[1] *Op. cit.*, p. 162 (A).

extent true: there have always been individuals who have done strenuous work without regard for compensation. On the whole, however, the fact that favourable results for the company bring ample financial rewards for the executives is undoubtedly an efficient incentive. This is all the more so as long-term contracts are unusual in the U.S.A. and executives who are not able to show tangible results cannot expect to retain their positions for long.

According to an investigation under the auspices of T.N.E.C.[1] the executive heads of 35 giant corporations, which group included 10 of the 20 largest industrials, the 8 largest utilities and the 8 largest railroads, had an average service of about 11 years. It is also interesting that the large majority of the executives concerned were appointed by promotion within the company, the percentage of internal selection being 90 per cent. in the case of industrials, 75 per cent. for railroads and 70 per cent. for public utilities.

It seems therefore that at least in the corporations investigated there could not have been much complaint against the management. Stress is laid on the fact that it is becoming increasingly difficult to fill vacancies with able executives, and in large corporations there appears progressive danger of bureaucratic rigidity. The future of corporate enterprise depends to a great extent upon whether this danger can be coped with.

SOURCES

See at end of § 27, particularly Monograph 11 of the Temporary National Committee: "Bureaucracy and Trusteeship in Large Corporations" (Washington, 1940).

29. Publicly Owned Corporations

We have seen that in the era of mercantilism the State not only promoted certain economic activities by import duties, export bounties and direct subsidies, but save in Great Britain itself nearly everywhere took part in business activities. In some cases this was done by the establishment of State-owned enterprises, in others by State participation in business corporations. The former course was followed in Germany, the latter in France (see §§ 4 and 12). Even in the U.S.A. both the Federal and the States Governments adopted this method to some extent. Thus the Federal Government took shares in the Bank of North

[1] Monograph 11, p. 46.

America and in both the First and Second Bank of the United States. Similarly many American States promoted the creation of State banks and internal improvement companies with substantial share subscriptions.

With the acceptance of *laisser-faire* this method of direct participation was abandoned and by about the middle of the 19th century there were practically no State-owned enterprises. The construction of railways also was left to private initiative, and in so far as their promotion was regarded as desirable in the public interest, the necessary support took the form of loans, grants of land, income guarantees, and so on.

It was otherwise in the German States. In Prussia the State retained the ownership of a bank, of several mines and factories, and an attempt was made to develop the railway system as a State enterprise, the scheme being abandoned only for lack of financial means. In Austria several railroads were actually built and managed by the government until financial difficulties compelled it to sell them to financial groups. In the eighteen-seventies, however, Bismarck completely reversed this process, and in Prussia the main railways were taken over from the companies by the State. The same was done subsequently in the other German States, in Austria, Italy and many other countries, while in France a new State-owned railway system was built up beside the existing privately owned lines.

Railways and other State-owned enterprises were carried on as special departments of the civil service. Bureaucracy, with plenty of red tape, overstaffing and political patronage was rampant nearly everywhere, and financial results were generally poor. As a conspicuous exception the Prussian railway administration was most efficient, and produced a surplus for the Treasury which from 1909 until the First World War was quite considerable. On the invested capital the railways yielded:

In 1909	5·09 per cent.
„ 1910	5·74 „
„ 1911	6·44 „
„ 1912	6·29 „
„ 1913	5·70 „

whereas the rate of interest on the State bonds issued to cover the purchase prices and investments was considerably lower. In Bavaria and probably also in Saxony the railways were always passive. In Austria and Hungary likewise the financial results were unsatisfactory.

The erection of gasworks, electric light and power plants and the construction of local tramways was nearly everywhere left to private enterprise, but subsequently and before 1914 a great number of these had been taken over by the municipalities in many European countries.

During the First World War all the belligerents formed centralised agencies, mostly in the form of corporations, for the purchase of raw materials, the production of munitions and the production and distribution of various commodities. All these were dissolved after hostilities had ended.

In the period between the two World Wars a number of corporations were created in Great Britain and on the European Continent for economic purposes. Two types in particular evolved: the wholly publicly owned corporation, called for short the public corporation (or in the U.S.A. "government-owned corporation"), and that in which the State or other public body furnished part only of the capital and reserved for itself some influence in the management. These are usually called semi-public or mixed corporations. This latter type became widespread on the European continent, especially in post-war Germany, in respect of public utilities.

The depreciation of the German currency and the collapse of public credit caused many municipalities to reduce their financial burdens. For this purpose electric light and power plants, local tramways, etc., were transferred to new companies, A.G. or G.m.b.H., at a fixed valuation, and part of the share capital sold to private groups, the remainder being retained in public ownership. The townships concerned reserved, usually by agreement, the right to appoint to certain posts on the board (*Aufsichtsrat*). The validity of such agreements was doubtful, and many Courts and writers held that, although inoperative as against the company, they were nevertheless valid and enforceable as against the other party, i.e. the shareholder with whom the agreement was made. The Supreme Court,[1] however, declared such agreements invalid as against public policy. This impasse was ended by § 88 of the Companies Law of 1937, which made it possible by the articles to reserve the right to appoint by delegation one-third of the board, provided the shares were nominative and transferable only with the company's assent. Shareholders who had such a right of delegation had also the

[1] R.G.Z. 131, 179.

right at any time to withdraw their delegates and to appoint others to fill the vacancy.

Whether the municipality had the power to give binding instructions to its delegates was disputed. It is reported [1] that in several cases town councillors and town clerks refused to follow such instructions. There were disputes also with regard to their fees. Berlin, Hamburg and some other municipalities prescribed that their delegates must surrender to the City any fees received as members of boards, and two Prussian ordinances of 1924 and 1925 provided that civil servants delegated on to the boards of companies might retain each year 600 marks of directors' and 1000 marks of chairmen's fees, but must pay over any amount in excess of those sums. But in many cases no such agreement or instruction existed. The electric and gas undertakings of the township of Stendal formed a G.m.b.H.; there was no board of supervision, and the form of control exercised was that the town had the right to delegate to the general meeting six members, the other shareholders three, the town holding 74 per cent. of the capital. The nine delegates agreed that they should receive 10 per cent. of the dividends paid by the G.m.b.H. to the shareholders. This was done for four years without the assent or knowledge of the township. The fees were in any case in excess of the usual amount, reaching 2–2½ per cent. of the turnover. The town of Stendal initiated proceedings for the recovery of the fees paid to their delegates, and the courts ordered the surrender of the amounts to the town.

In Great Britain and the U.S.A. the form of the entirely public corporation was adopted for such organisations. In Britain the Central Electricity Board, the British Broadcasting Corporation and the London Passenger Transport Board were set up as publicly owned corporations, and the same method was applied in the U.S.A. for the various organisations created to promote economic recovery under the New Deal, such as the Reconstruction Finance Corporation, the Federal Deposit Insurance Corporation and several others, as well as the Tennessee Valley Authority.

The mixed (semi-public) corporation was also in use. Thus the telecommunication services of the British Commonwealth were integrated by the formation of two new companies, Cable and Wireless Limited, now called Cable and Wireless (Holding)

[1] Heymann and Bergmann, Z.H.R. 97, 56.

Limited, to acquire and hold practically all the shares of the then existing cable companies and of the Marconi Wireless Company Limited, and a second, an operating company, Imperial and International Communications Limited, subsequently renamed Cables and Wireless Limited, which acquired the communications assets of the said companies besides certain cable lines of the Commonwealth Governments, and at first the lease and subsequently the ownership of the beam wireless stations of the United Kingdom, from the Post Office. Separate companies were created in Canada, Australia, New Zealand, South Africa and India in which Cable and Wireless had substantial holdings without attempting to control policy. The British Government reserved important rights as to management. Two directors of the operating company, one being the chairman, were to be approved by the Government, and one half of any net revenue in excess of the standard revenue fixed by agreement between the Company and the Government was to be used for the reduction of rates or such other purposes as the Imperial Communications Advisory Committee (now the Commonwealth Communications Council) might approve. In the course of reorganisation in 1938 the interest of the United Kingdom Government was fixed at 2,600,000 out of the 30 million shares of the Company. By 9 & 10 Geo. VI, c. 82, of 1946, however, all the shares were taken into public ownership.

In a large oil concern, the Anglo-Iranian Oil Company (earlier called the Anglo-Persian Oil Co.) the British Government has always had a substantial interest. Two of the directors are Government appointees and do not have to qualify by shareholding. They have power to negative the decisions of the board, though this power must not be used to interfere with the ordinary management of the business.

For the period between the wars we may also mention the attempt made to commercialise the management of the German railways. Mainly so that the revenue could be used for reparation purposes, these railways were unified and turned over to a company whose preference shares were surrendered to the victorious Powers. From a financial point of view this was not a success. Profits were:

For 1926	3·309 per cent.
,, 1927	3·385 ,,
,, 1928	3·326 ,,
,, 1929	3·310 ,,

This poor result might have been due to the dislocation consequent upon the territorial provisions of the Peace Treaty and the ensuing adverse circumstances. Competent critics, however, asserted that the reorganisation was rather superficial, the railways were overstaffed and the expenditure, particularly on station buildings, too lavish in view of the changed conditions. Passenger fares on the other hand were artificially held at a low level under political pressure and certain favoured industries were subsidised by rebates and low charges. There were also complaints that the management and the employees could not adapt themselves to the technique and spirit of business administration and commercial accountancy.

During the Second World War the requirements of war economy led to the creation of numerous Government-owned corporations, and with the end of hostilities a mighty wave of nationalisation set in both on the European Continent and in Great Britain. In Eastern Europe either the whole or a large part of industry and finance was nationalised, while in Britain the Bank of England, the overseas telecommunications already mentioned, air communications, the coal industry, the production and distribution of electricity and gas and most forms of transport have become national property. It is the intention of the Labour Party to nationalise the iron and steel industry also. Public opinion in the U.S.A., on the other hand, is apparently opposed to further extension of government ownership.

The question whether and how far nationalisation should be adopted is one of economic policy. It is an easy question for those who are convinced that public interference in business is evil, and equally easy for those who in virtue of their socialist creed regard it as the goal to be aimed at in all circumstances. The difficulty begins if we assume, as the present writer does, that nationalisation is not an end in itself but merely a means to the better satisfaction of the needs of the community. The question is then one to be decided in each case on its merits; nationalisation is justified if it is necessary to exclude private monopoly dangerous to the community, or if the public interest is better served by public ownership. It is therefore obvious that a discussion of its advisability would be beyond our scope. We must, however, examine the various methods of taking enterprises into public ownership and the structure of publicly owned (government) corporations.

A government may take over an already existing corporate enterprise either by acquiring the shares or by purchasing the assets. Where governments by agreement or by compulsory transfer have acquired the whole share capital of an existing corporation, it is possible to maintain the structure intact and to carry on the business in the same way as was done before the acquisition. The change is merely that there is a single shareholder, the State, and that the board consists of appointees of the Government. This method was chosen by the U.S.A. Government in respect of the Panama Railway Company, and has been followed in many instances by governments of the European continent.

In Great Britain, the Act 9 & 10 Geo. VI, c. 27 (1946), by which the capital stock of the Bank of England was brought under public ownership, provided that the whole capital of the Bank be transferred free of all trusts, liabilities and encumbrances to the nominee of the Treasury. The directors are from the day of the transfer the members of the Bank as a body corporate together with the person who at any time holds the stock of the Bank on behalf of the Treasury, notwithstanding that they do not hold stock of the Bank. In the case of Cable and Wireless Limited (9 & 10 Geo. VI, c. 82) the compulsory transfer of the shares which were not already held by the Treasury was made to such persons as the Treasury should nominate. The said persons were to be entered on the register of members and were to be entitled to all the rights and advantages of members, even though they were not entered on the register of members on the day appointed for the transfer.

Whereas in the case of the Bank of England there is no provision for the maintenance of the court of proprietors, which would of course be pointless, its place being taken by the court of directors, in the case of Cable and Wireless Limited the persons nominated by the Treasury may hold a general meeting on the day appointed for the transfer, and if a majority is present, they shall be deemed to be a duly constituted general meeting although it may not have been duly summoned. A resolution may be proposed and passed as a special resolution within the meaning of the Companies Act even though the formalities required by that Act may not have been complied with. It is further provided that no petition for the winding up of the company shall be presented and that the members shall not be liable for the debts

of the company on the ground that their number is less than that required by law. These differences in the regulations are to some extent consequences of the fact that the Bank of England is a chartered company, whereas Cable and Wireless Limited was created under the Companies Act.

But there is a further difference in dealing with profits. In the case of the Bank of England it is provided that after it has been taken in public ownership no dividends shall be declared or paid, but that in lieu thereof the Bank shall pay to the Treasury in half-yearly instalments an amount sufficient to cover the interest of the Government stock issued to the holders of bank stock as the redemption price of their holdings. Cable and Wireless on the other hand will declare dividends and pay them to the Treasury.

In other cases, however, and especially when the object is to establish a new enterprise under public ownership, the second alternative, the creation of a public corporation, was as a rule chosen.

Where already existing enterprises are taken over into public ownership in States recognising private property as a basic institution, it is obvious that if the government is unable to secure the acquisition of an enterprise by consent and negotiation, or prefers to adopt compulsory transfer of ownership, it must pay compensation. This principle is denied only by the U.S.S.R., and even the so-called satellite states in the Russian orbit render at least lip service to the rule of compensation, although its actual payment is generally postponed, in many cases *sine die*.

In Great Britain, when the London Passenger Transport Board under 23 & 24 Geo. V, c. 14, took over in 1933 the underground railways, tramways and bus routes in the Metropolitan area and its suburbs, fair compensation was paid in stocks of the Board, and many people attributed the not too satisfactory financial results of the Board to the burden of compensation.

The nationalising Acts of 1946 and 1947 are based on the principle of fair compensation, although they differ in details. The Bank of England Act provided that compensation should be paid in 3 per cent. Government stock to the amount which would provide an interest equal to the gross dividend declared during a period of twenty years immediately preceding 31 March 1945. In other words, since in the relevant period a dividend of 12 per cent. was paid, the compensation was equal to 400 per

cent. of the nominal value of the bank stock. It is not possible to ascertain the relation of this compensation to the actual value of the stock, since as mentioned in § 5 the actual internal position of the Bank of England was never disclosed. In any case the stockholders received government stock not redeemable for twenty years and a secured income equal to their dividends, and practically no complaints were voiced on their part.

The shareholders of Cable and Wireless Limited have been granted compensation to the amount "which the undertaking might be expected to realise if sold in the open market as a going concern by a willing buyer on the basis of: (*a*) the net maintainable revenue, and (*b*) the number of years' purchase applied thereto". Net maintainable revenue is taken to mean the net annual revenue which the undertaking might reasonably be expected to earn in future, taking into account any circumstances which might reasonably be expected to have affected that revenue, but leaving out of account the effects of the nationalising Act and the so-called Bermuda Act, i.e. an agreement concluded in December 1945 between the Governments of the United Kingdom and of the Dominions and the Government of the United States. In default of agreement the amount of compensation is to be determined by a tribunal consisting of three members: a judge to be nominated by the Lord Chancellor, an accountant to be nominated by the President of the Institute of Chartered Accountants, and a person experienced in matters of finance or business to be named by the Governor of the Bank of England.[1] The compensation thus determined is to be made by the issue of government stock of equal value in the opinion of the Treasury to the amount of the company's compensation on the date of the issue, having due regard to the market values of other Government securities existing at that date. Interest is to be paid for the period between the taking over of the shares and the issue of the stock.

The regulation of compensation under the Coal Nationalisation Act of 1946 (9 & 10 Geo. VI, c. 59) is very complicated. This was perhaps inevitable, since not only the interest in unworked coal, coal mines and colliery concerns, but also a number of subsidiary interests have been transferred, in part by the provisions of the Act, in part at the option of the National Coal Board or of the colliery owners. The compensation was defined

[1] Sec. 2, 9 & 10 Geo. VI, c. 82.

as consisting of: (*a*) the coal industry value of the transferred interests, and (*b*) their value for subsidiary purposes. The aggregate amount of the compensation for the coal industry value of all transferred interests was fixed at £164,660,000 by a tribunal formed in pursuance of an agreement made before the passing of the Act between the Minister of Fuel and Power and the Mining Association of Great Britain. The distribution of this aggregate amount among those entitled to compensation is to be made by use of a machinery by which compensation units are formed and allocated to one or other of the "valuation districts". District valuation boards are constituted, working under a Central Valuation Board which has to make the apportionment as between valuation districts.

The value of each compensation unit is to be determined by the respective District Valuation Board, and at the same time is to be determined how much of that value is coal industry value and how much the value for subsidiary purposes. The general direction is that the value of a compensation unit shall be taken to be the amount which might have been expected by the sale in the open market to a willing buyer if the Act of Nationalisation had not been passed, on the assumption that the purchaser could use the property in which the transferred interests exist with other assets used in association therewith before the transfer, no allowance being made for the compulsory nature of the transfer. There is adequate protection for the compensation units by a review of the determinations of the District Valuation Boards by referees, and in certain cases a judicial review by the High Court is provided for. Claims for compensation are to be met in Government stock, except for certain assets in respect of which a money payment is necessary to meet the obligations of the compensation unit in question. As a rule such stock is subject to restrictions as to its disposal.

The Transport Act 1947 (10 & 11 Geo. VI, c. 49) approaches the question of compensation from the viewpoint of the holders of railway and canal securities. They are to be satisfied by the issue of transport stock at a valuation equal to the average of several quotations on the Stock Exchange as fixed in the Fourth Schedule of the Act, and where no quotations are available the value is to be determined by the established Arbitration Tribunal. The interest due on such stock will be considerably less than the income realised by the railway companies under their wartime

agreement with the Government, which was fixed on the basis of the actual revenue for the year 1938.

In respect of the long-distance road haulage enterprises to be taken over under the Transport Act, the compensation for vehicles is to be calculated on the basis of the cost of replacement by a new vehicle of similar type at the date of transfer, with a deduction according to the age of the vehicle, and allowance for its condition at the date of transfer. For other property compensation is to be equal to the amount which the property would fetch in the open market at the date of the transfer, as if the Transport Act had not been passed. For the total or partial cessation of the business caused by the transfer a sum equal to not less than twice and not more than five times the average of the net annual profits is to be paid. Detailed rules are contained in the Act in respect of the meaning and calculation of the said average profit. Compensation for transferred road transport undertakings is to be paid in transport stock. But if the amount payable to a person on any date does not exceed £20,000, he may demand its payment in cash up to £2000. For the confirmation of agreements and the settlement of disputes a special Transport Arbitration Tribunal is established. This is to be a court of record and its orders are to be enforceable as if they were orders of the High Court or the Court of Session respectively. It is to consist of a president with legal experience, and two other members, one with experience in business, the other in finance—all three being appointed by the Lord Chancellor (or in Scotland the Lord President of the Court of Session in the case of the legal member).

The Electricity Act 1947 (10 & 11 Geo. VI, c. 54) adopted a compensation regulation similar to that of the Transport Act. If the owner of the absorbed undertaking is a company, compensation is to be paid to the holders of securities on the basis of the average of the quotations of the said securities on certain dates, or if the owner is a local authority, by payment of a sum equal to any loan raised for the purposes of the undertaking and any money advanced by the local authority concerned for the said purposes. For the severance of the transferred electricity undertakings from other activities of the local authorities a sum of £5,000,000 is to be divided among them.

In the case of composite companies, i.e. those which beside electricity, supply gas or water, the compensation for the electricity

undertaking taken over shall include, beside the payment for the proportionate part of the securities to be reckoned on the aforementioned basis, compensation in respect of the severance of the electricity undertaking from the company's other undertakings, equal to five shillings for each complete one thousand units of electricity sold by the company during the year 1946.

To the holders of securities compensation is to be made by the issue of British Electricity Stock of such amount as in the opinion of the Treasury is equal on the vesting day to the value of the said securities, regard being had to the market value of Government securities on the same day. In the case of local authorities payments are to be made in cash.

In the case of disputes a special tribunal, the Electricity Arbitration Tribunal, organised on the same basis as the Transport Arbitration Tribunal, shall be competent.

Looking at the matter as a whole, it is obvious that the British Nationalisation Acts aim at a fair settlement of the question of compensation. But the regulations, of which we give only a very short summary, seem complicated and will probably give rise to many disputes. Simpler solutions would in our opinion have been preferable, even if in some cases they were to have involved larger compensation, since after all it is not so much the amount of compensation paid to the former owners as efficient management which decides the financial results of the nationalised industries.

The carrying on of these nationalised industries is entrusted to special corporate bodies, called the National Coal Board, the British Transport Commission and the British Electricity Authority respectively. Each is to be a body corporate with perpetual succession and power to hold land without license in mortmain.

The Electricity Act 1947 establishes under the British Electricity Authority (the "Central" Authority) fourteen Area Boards, which are likewise corporate bodies, and beside these the North of Scotland Board established under the Hydro-Electric Development (Scotland) Act (6 & 7 Geo. VI, c. 32) is maintained. The Area Boards will acquire from the Central Authority bulk supplies of electricity and distribute them to customers in their area. They may further acquire from other area boards bulk supplies of electricity and supply it to consumers in other areas, and further may acquire by agreement with other persons bulk supplies of electricity. In this way the

Area Boards may enter into contractual relations with the Central Authority and with each other. The Central Authority, however, is to co-ordinate the distribution of electricity by the Area Boards and exercise general control over their policy.

A higher degree of centralisation is provided for the coal industry. The National Coal Board is the one and only legal entity controlling the nationalised industry; the regional coal boards are merely administrative agencies.

The Transport Act 1947 provides for the establishment of executives which shall be bodies corporate and shall exercise, under schemes made by the British Transport Commission and approved by the Minister, such functions as shall be delegated to them. The functions of the Executives are to be described in the schemes which are to be published in the *London Gazette*. Every Executive shall give effect to the directions of the Commission in the exercise of its function. The delegation of functions shall not empower the borrowing of money unless temporarily for the carrying on of the current business of the Executive and when authorised by the Commission.

Within the scope of the delegation any rights and liabilities arising from the exercise of the delegated powers shall be treated as against third parties as the rights and liabilities of the Executive, and the Executive shall be considered as employer of the officers and servants of the Commission so long as they are under the control of the Executive by virtue of the delegation. Should, however, any Executive fail to pay any sum adjudicated by judgment or order within 14 days from the day on which execution becomes leviable, the said judgment or order shall be enforceable against the Commission.

Whether this framework will ensure the decentralisation of powers necessary for successful management of an organisation as vast and diversified as the British Transport system, the future alone will show.

The constitutions of the respective Boards are on similar lines. The National Coal Board consists of a chairman and eight members. The British Transport Commission consists of a chairman and not less than four or more than eight members, of whom the chairman and not less than four members shall give full-time service. Similarly each of the Executives shall consist of one chairman and not less than four or more than eight members, all of whom it seems will be required to give full-time service.

The British Electricity Authority is to consist of a chairman and not less than four or more than six members. One or more of these may be appointed to act as deputy-chairman, four others shall be appointed in rotation to act as chairman of the Area Boards, and one shall be chairman of the North of Scotland Board. Each Area Board shall have a chairman and not less than five or more than seven members, one of whom is to act as deputy-chairman. One member shall hold the office of Chairman of the Consultative Council of the respective area.

All the appointments are to be made by the appropriate Minister. The appointment of the Executives shall be made after consultation with the Commission, and those to the Area Boards after consultation with the Central Authority.

All these appointments are to be made with due consideration of the qualifications of the persons concerned. They should be persons who appear to the Minister to have had experience in industrial, commercial and financial matters, applied science, administration or organisation of works (Coal Board). The Transport Act requires wide experience and capacity shown in transport or in the above-mentioned fields, omitting, however, applied science, whereas the Electricity Act requires in the first place experience and capacity in the generation and supply of electricity, enumerating all the other fields and including applied science. The members of the Area Boards may also qualify by experience in local government or agricultural matters.

The Transport Act provides that the Minister shall satisfy himself, before making an appointment, that the person concerned has no such financial or other interest as is likely to prejudice the discharge of his functions, and that a member who is directly or indirectly interested in a contract to be made by the Commission shall disclose his interest and shall not take part in any deliberation and decision thereupon. Members of the House of Commons are disqualified from appointment or membership.

The terms of office are to be fixed by the Minister; emoluments and pensions, and pensions and gratuities payable in case of death to other persons, are to be determined by the Minister with Treasury approval. The Minister has wide powers in respect of appointments, and the Transport Act is alone in providing that he is to lay before Parliament a statement of salaries or fees and allowances as soon as may be after the first appointment of a member of the Commission.

Although the duties and powers of the three Authorities are defined in detail in each of the three Acts, the Minister has power to issue directions as to management. How far this power is to be exercised and to affect the powers given to the respective authorities is largely a matter of discretion.

Each of the three Acts provides for consultative bodies. For the coal industry there are to be two: the Industrial Coal Consumers' Council and the Domestic Consumers' Council. Each is to consist of such number of persons as the Minister thinks fit. He is to make the appointments after consultation with such bodies as he regards as being representative of consumers and sellers of fuel. The Minister may also appoint regional councils for such localities as he thinks expedient, and may dissolve them or vary the locality for which such council has to act.

Under the Transport Act 1947 there shall be a Central Transport Consultative Committee for Great Britain, as well as Consultative Committees of Transport Users. Each committee shall have an independent chairman. Otherwise the number of members is to be determined by the Minister, who shall appoint such after consultation with such bodies as he thinks fit to represent various stated interests. Other appointments shall be made from among the members nominated by the Central Transport Commission, with the proviso that in the case of the Central Consultative Committee the nominations shall include at least one member of the Commission. No member of any consultative committee shall be disqualified from being a member of the House of Commons.

Under the Electricity Act 1947 consultative councils shall be established for each area, consisting of not less than twenty or more than thirty members. Not less than half or more than three-fifths shall be appointed by the Minister from a panel nominated by associations which appear to the Minister to represent the local authorities of the area, while the remainder shall be appointed by the Minister after consultation with bodies representing certain stated interests. The chairman, but not the other members, of the Consultative Councils may not be members of the House of Commons.

The term of office of all these bodies under the three Acts is to be fixed by the Minister. The posts on the consultative bodies are remunerated at rates fixed by him with Treasury approval. The Transport and Electricity Acts restrict the

allowance to compensation for any loss of remunerative time and out-of-pocket expenses.

The purpose of the consultative bodies is to consider representations made to them and to make representations to the Minister. The Transport and Electricity consultative bodies may make representations and recommendations also to the Transport Commission or the Central Electricity Authority respectively even without such representation. Similarly the Minister may refer certain questions to the consultative bodies for consideration. Each of the consultative bodies has to make an annual report, which is to be laid before each House of Parliament.

The basic idea that consultative bodies shall function beside the managements of the nationalised industries, supervise their activities and take the initiative in suggesting alterations of business policy and improvements as to its execution, is undoubtedly sound. An adequate consultative body may go far in connecting the management with those fields of economic life with which they are in relation. Moreover the advisory body attached to the London Passenger Transport Board has furnished practical experience as to the constitution and working of such bodies. We think, however, that the purpose of such bodies would be better served, if the members were delegated directly by the respective organisations, such as chambers of commerce, industrial associations, local authorities, and so on, instead of being appointed by the Minister.

Each of the Acts contains detailed provisions in respect of financial management, of which only a short summary can be given here.

In the case of the National Coal Board the Minister may advance the sums necessary to defray expenditure properly chargeable to capital account and to provide for working capital. These advances shall not for the first five years exceed £150 millions. In order to meet its obligations the Board may, with the assent or authorisation of the Minister, borrow temporarily or otherwise up to the amount of £10 millions. Interest on advances is to be paid to the Minister, and the Board has to reimburse payments made for compensation including the service of the stock issued.

A reserve fund is to be created, which is to be applied for the purposes of the Board, and the net revenue is similarly to be used exclusively for the same purposes. Otherwise the Minister has

power to give directions with Treasury approval for the establishment, management and application of the reserve fund and for the application of the net revenue.

The Transport Act 1947 provides that the borrowing powers of the British Transport Commission shall be exercised by the issue of British Transport Stock; the amount borrowed shall not exceed £250 millions, apart from the amounts required for compensation for assets which are to be acquired and the amounts needed for the redemption of British Transport Stock. The Act also prescribes the establishment of a general reserve without prejudice to the establishment of appropriate reserves for replacements and other purposes and proper provision for depreciation or renewal of assets. Similarly, proper provisions for the redemption of capital are to be charged to revenue.

Under the Electricity Act not only the Central Authority but also the Area Boards have borrowing powers, and the Central Authority may apportion the liabilities in respect of stock, loans, payments of compensation to local authorities and repayment for loans made by the Central Authorities and interest thereon. Following such apportionment the Central Authority may require the Area Boards to contribute towards the satisfaction of the said obligations. Both the Central Authority and the Area Boards are to charge to revenue account adequate sums to provide for depreciation, renewal of assets and the redemption of capital. The establishment of a central reserve fund is prescribed on lines similar to those in the Transport Act. One of the purposes of these reserve funds shall be the prevention of frequent fluctuations in charges.

As we see, the Treasury has controlling powers in financial matters beside the wide powers of the Ministers. Both the Transport Act and the Electricity Act provide a Treasury guarantee for the principal and interest on British Transport and British Electricity Stock.

All three Acts provide that the nationalised industries shall not be exempt from liability for any tax, duty, rate, levy or other charge, whether general or local.

In respect of accounts the regulations contained in the three Acts are on similar lines with some differences of detail. The National Coal Board has to keep proper accounts and other records, and to prepare an annual statement in such form as the Minister may direct, conforming to the best financial standards

and distinguishing colliery activities and each of the ancillary activities of the Board.

The Transport Act provides only that the Commission shall cause proper accounts and other records to be kept and that the annual statement shall be framed in such a form and contain such particulars as the Minister with the approval of the Treasury may from time to time direct. In addition the Commission shall compile and render such periodical statistics and returns relating to each of its principal activities, in such form and at such times as the Minister may require. The annual statement shall as far as possible, in combination with these statistics and returns, give separate information in respect of the principal activities and show their financial and operating results.

The Electricity Act contains provisions in respect of accounts and records similar to those of the Coal Industry Act, providing, however, that each Area Board must keep separate accounts and records and prepare separate annual statements. The statements shall be such as to secure separate information in respect of generation, distribution and each of the other main activities of the Board concerned, and to show as far as possible the financial and operating result of each activity.

The accounts are to be audited annually. Whereas the Coal Industry and Transport Acts simply provide that the auditing shall be done by auditors appointed by the Minister, the Electricity Act requires that no person shall be qualified unless he is a member of one of the recognised bodies of accountants. Thus, in respect of the accounts of both the Coal Board and the Central Transport Commission it is in the discretion of the Minister to appoint internal auditors who hold salaried office and who may or may not be qualified accountants. In the case of the Central Electricity Board and the Area Boards only qualified accountants may be appointed.

Actually the Minister of Fuel and Power has appointed as accountants salaried employees of the Coal Board to act as auditors, and the same may be done in the other cases.

The establishment of permanent auditing departments is undoubtedly a sound policy; we think, however, that additional auditing of the accounts by independent auditors would be in the public interest and the expenditure involved would be amply justified.

The Coal Board, the Transport Commission and both the

Central Electricity Authority and the Area Boards shall make an annual report to the Minister on the exercise and performance of their functions in the past year, their policy and programme. The directions issued by the Minister during the year are to be set out in the report, but these may be excluded by the Minister if it be against the national interest. Both the annual reports and the audited statements are to be laid before Parliament, and the view taken by the present Government is that parliamentary control of the State-owned industries should be exercised only once yearly on the basis of the reports and statements. Should this view prevail, Parliament would be deprived of the possibility of influencing business policy during the financial year, and control would be reduced to criticism of past transactions and events, and public discussion of the problems would hardly be possible. The main argument in favour of this view is that discussions in Parliament would impair the independence of the managing bodies. Considering the far-reaching powers of the respective Ministers, this cannot be accepted as a satisfactory justification of the restriction. It is, however, too early to ascertain how this form of public accountancy and control will work in practice. At the time of writing the annual report and statement of the National Coal Board for 1947 has not yet been published, while the published quarterly statements, as was to be expected, give no complete picture.

In this connection we cannot omit to mention how successfully the American Congress and Government grappled in the case of the Tennessee Valley Authority (T.V.A.) with the problems facing a publicly owned enterprise. The late President F. D. Roosevelt in his message to Congress defined the proposed legislation: "to create a Tennessee Valley Authority, a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise".

The purposes of the Authority were defined on clear, simple, inclusive and broad lines. It was further made clear that in the construction and operation of the T.V.A.'s dams and plants, flood control and navigation were to have priority over power production. The administration was entrusted to a board of three persons to be appointed by the President, who became responsible for the construction and operation of the whole enterprise. The appointment of all officers and employees was vested in the Board, and the Act establishing T.V.A. prescribed

that in appointments "no political test or qualification shall be permitted or given consideration, but all such appointments shall be made and promotion given on the basis of merit and efficiency"; the sanction of removal from office by the President is provided should the Board violate this rule. We are told that the Board successfully withstood political pressure and patronage, but on the other hand prohibited in 1936 all political activity by its officers and employees. This prohibition extends to candidature for any office or taking active part in elections, except by voting, and includes even municipal elections.

T.V.A. has to make an annual report to Congress in great detail, and reports on special subjects are made from time to time. The accounts are based upon up-to-date progressive business methods, including detailed cost accounting. Financial reports are prepared monthly, the annual statement including balance sheet and income account. Beside the audit by the Comptroller-General of the U.S.A., the accounts are audited by a leading firm of accountants, whose report is of the same character as in the case of large private corporations. Elaborate reports on accounts are made annually to the President through the Bureau of the Budget, and to the Appropriations Committees of both Houses of Congress.

Besides debates on the annual reports, several special investigations have taken place. A joint congressional Committee formed in 1938, equipped with a considerable technical staff, investigated T.V.A. Actually control by Congress is intensive; not only has T.V.A.'s programme been repeatedly reviewed in connection with amendments of its charter and appropriations, but even a contract made by T.V.A. for the purchase of the plant of the Tennessee Electric Company has been examined by Congress in detail. The purchase price was $78,600,000; the contract was confirmed.

Active meddling in the activities of T.V.A. was quite exceptional. Lilienthal, the Chairman of the Board, reports only one instance: in 1942 maximum expenditure for travel was fixed by law. This was done against the Board's recommendation and actually resulted in higher costs, and the law was repealed in 1943.

The costs of investment totalled on 30 June 1943 $475 millions. After completion of the dams this rose to about $750 millions, of which approximately $450 millions represent power investment.

Of this expenditure up to 1943 \$65 millions were procured by the issue of T.V.A. bonds, about \$50 millions by contributions from the electricity ratepayers and the remainder by appropriations of Congress.

The revenue of T.V.A. is derived only from the sale of electric power. In the year 1942–3 the total revenue was about \$31,500,000. After tax payments of about \$2,000,000 and depreciation amounting to about \$6,000,000, the net revenue was about \$13 millions. This result has been achieved although the T.V.A. charges for power resulted in considerable saving to the consumers. The immense indirect benefits of T.V.A. in river regulation, protection against floods, soil conservation, improvement of agriculture and living conditions over the whole region cannot be estimated in terms of money.

We are aware that the nationalisation of whole industries is a vaster and more complicated task. We think, however, that a close study of the structure and actual working of T.V.A. would be of great value for all countries concerned with nationalisation or the creation of new, publicly owned corporations.

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30. Economic Organisations in the U.S.S.R.

Socialist economy seeks to place all means of production under public ownership. Whether this aim can ever be fully achieved may be doubted, but regardless of the measure of socialisation and the scope left for private enterprise, the crucial question is how the production and distribution of goods can be organised under a socialist economic system. It is therefore of great interest to learn how this problem is solved in the U.S.S.R.

We shall refrain from expatiating on the evolution since 1917, and describing the well-known phases of War Communism, the N.E.P. period and the successive five-year plans, and restrict ourselves to a short sketch of the present structure. Exactitude

cannot be claimed even in this restricted field, as many sources are published only in Russian and are accessible only at second-hand in translations, while others are not accessible at all.

In 1939 only about 900,000 hectares (*c.* 2,220,000 acres) of arable land were left to the cultivation of individual farmers; 12,400,000 hectares (*c.* 30 million acres) were cultivated as State farms (*sovkhozes*), while 117,200,000 hectares (*c.* 289 million acres) were left to a kind of co-operatives (*kolkhozes*). The ownership of land is vested in the State, but the use of the land assigned to kolkhozes is declared to be granted for ever. This right of use is qualified by the possibility that certain parts of the land assigned to a given kolkhoz may be transferred to a new one by the government if the common weal so require. The working capital of the kolkhozes (stock, agricultural machinery, etc.) is in their own ownership; it is the "indivisible fund" to be used for the cultivation of their land. The most important means of production, however, tractors, combines, etc., are State property, and their services have to be paid for by the kolkhoz.

Inside the kolkhoz every member is granted a certain amount of land for his personal use, its maximum limits varying as a rule from one-quarter to one-half hectare, or in certain areas up to one hectare; a limited number of animals, such as one cow, some sheep, pigs and poultry may also be privately owned. These parcels of land are the basis of the "auxiliary husbandry" of the members; they may use them as kitchen-gardens or orchards and sell their surplus products in the open market.

The members of the kolkhozes must take part in the collective cultivation of the land assigned to the kolkhoz, according to plan. The member who does not fulfil his duty to work in and for the kolkhoz is subject to a deduction of his share in distribution and may ultimately be expelled.

Membership is voluntary, and actually began with the peasant families who were occupying the land assigned to the kolkhoz. Members may leave the kolkhoz, but cannot then claim a share in its indivisible funds.

In principle the kolkhozes enjoy a large measure of self-government, as expressed in their model articles prepared by the government; actually, however, this freedom is greatly qualified by the government's power to direct agricultural production.

The kolkhozes have to surrender a substantial quota of their products to the government for the use of the land. Furthermore,

for the services of the machine traction stations (ploughing, sowing, harvesting and threshing) they have to pay fixed fees, mainly in kind. Any surplus in excess of the distributions to their members is to be sold to the government, or in certain cases partially in open market.

The members of the kolkhozes receive no wages or salaries; their only claim is to a share in the distributed product. This share is fixed according to the work done, reckoned on an ingenious system of "labour days", in which due consideration is given not only to the time spent on work, but to its nature and intensity. Distributions are made in kind to satisfy firstly the needs of the members and their families for staple foods. There are further distributions in cash, since the kolkhozes should have, and apart from total failure of crops actually do have, a certain cash income from the sale of their surplus products, a certain part of which is distributed, whereas the remainder is devoted to improvements or put into reserve.

In the management of the kolkhoz there is a conflict of interest between the work to be done for the kolkhoz and that devoted to the auxiliary husbandry, i.e. the work on the parcels of land allotted to the members for their own free purposes, since the average member is inclined to favour the latter. A similar conflict may arise in respect of cash distributions and the sums to be set aside. In both conflicts there is constant supervision and interference on the part of the authorities, and the government is active in ensuring effective results for the kolkhoz by limiting the auxiliary husbandry and granting extra payments for outstanding results.

There is great inequality between the kolkhozes, not only in size but also in results and in distributions in kind and cash, according to the differences in the site and quality of the land and to some extent also in the intensity of the work done. There are both very rich and very poor kolkhozes, and the members' level income differs widely.

The Second World War led to the destruction of many thousands of kolkhozes. Even those which never saw enemy action suffered by reason of lack of man-power and the deterioration of their equipment. Discipline inside the kolkhozes could not be fully maintained, and there were complaints that many members neglected work for the kolkhoz in favour of the cultivation of their own smallholdings. Since the end of hostilities much

energy is being devoted to reconstruction, the restoration of the standards of collective production and the retrenchment of the private activities of the members.

Many experts criticise the drawbacks of the constant governmental interference and the overstaffing of the bureaucratic machinery. There seems to be much truth in these objections; nevertheless the momentum of agricultural reconstruction is remarkable, and is mainly due to the work of kolkhozes, differing as they may from real co-operatives.

In industry and trade Soviet Russia's aim was total socialisation, even in the days of War Communism, when agriculture was left to private enterprise. Under the N.E.P. only enterprises employing not more than twenty persons could be carried on privately, and it is estimated that their share in the total industrial production did not exceed 5 per cent. The share of private enterprise in trade, particularly in retail trade, was much larger. During the five-year plan period these remnants of the N.E.P. were squeezed out, partly by taxation, partly by administrative methods. At present craftsmen are allowed to work on their own without employees, either individually or in co-operatives. Their part in industrial production is insignificant, though the actual percentage is not ascertainable from the published censuses. A census of the implements of production for 1936 gives the share of industrial craftsmen as ½ per cent. No individuals are engaged in wholesale commerce, and foreign trade has always been a State monopoly. Retail trade in towns is at present in the hands of government stores and shops, in all the rural districts in those of consumers' co-operatives. The independence and self-government of these co-operatives, however, is restricted, and they are mainly dependent for supplies on government industrial and distributive organisations. Nevertheless neither the consumers nor the authorities are satisfied with their activities, and *Pravda* has several times reprimanded the chairmen and managers of co-operatives for their inefficiency and lack of attention to consumers' needs.

Some private trade is carried on in the markets, such as the sale of the products of the auxiliary husbandry of kolkhoz members, trading by pedlars in districts remote from towns, commerce in luxuries, and lastly—in spite of prohibitions and prosecutions—there is some illegal trading.

The organisation of industry is based on the operation of

State enterprises on a separate accounting basis. Each enterprise is administered by a manager or a board responsible for its results.

In the days of the N.E.P. a marked difference was maintained between enterprises working exclusively for the State and those operated also for the satisfaction of customers' needs. Both were to be managed on a commercial basis, but whereas enterprises of the former category were to receive subsidies and their eventual deficits were covered by the State, the latter enjoyed a certain degree of independence. They were organised into "trusts" consisting of enterprises of a single class, created under a charter of the Supreme Council of National Economy. The fixed capital of these trustified enterprises remained in the ownership of the State; it could not be mortgaged, or made responsible for debts incurred. The current assets, however, were destined to cover the debts. The trusts were to be operated as independent legal entities and could enter into contracts with the State, with other State-owned enterprises, and with private persons. A part of their profits had to be used for building up and strengthening reserves and for the welfare fund of the enterprise; a part was to be distributed among the staff, and the remainder paid into the Treasury. Trustified enterprises were free to make contracts for the sale of their goods, but were bound to give preference on equal conditions to State departments and co-operatives. On the other hand, since the whole economy of the Soviet had a monetary basis, the trusts were dependent on credits from the Gosbank (the bank of issue), to which the contracts between State enterprises have to be submitted for approval. The Gosbank maintained the principle that if a State enterprise was unwilling to settle its debts, the Bank could enforce the settlement and drive the enterprise into bankruptcy, though this was hardly ever done. The Supreme Economic Council had power to liquidate any enterprise.

In the late twenties the independence of trustified enterprises was considerably curtailed and their supervision by government departments strengthened. Moreover profits became subject to income tax and the share of the Treasury in the net profits was increased.

From the first five-year plan onwards the distinction between the two classes of enterprise lost its importance, and the trusts were hardly more than administrative agencies for the better

supervision and co-ordination of enterprises. At present there are some enterprises which, owing to their size and importance, are under the direct control of the central government; others are under indirect control through the trusts to which they belong, and lastly some are local in character under the control of the appropriate Republic. The power of the central government to interfere with the affairs of any enterprise is, however, unlimited.

All enterprises are subject to income tax, and only half of the surplus realised in excess of the planned profits may be retained for the betterment of the living conditions of the staff and for special rewards.

The relations between the various State enterprises are based upon contract, and in case of dispute State arbitration is invoked. It is hardly conceivable that the decisions of this tribunal should not be complied with in view of the absolute power of the government to impose sanctions, and the possibility of a State enterprise being declared bankrupt and its current assets sold, i.e. transferred to another State enterprise, will hardly be realised.

Whether under these circumstances these undertakings may be characterised as juristic personalities is doubtful, unless we assume that under Soviet law there are two kinds of legal entities: one conferring the full status of personality, the other giving but a limited degree of authority. In fact, however, State enterprises do not enjoy full personality even in respect of current assets, and the power of the government to deal with the property assigned to them, i.e. to transfer it without compensation to another enterprise, is unlimited.

The provisions of the Soviet Civil Code seem therefore not to be applicable to State enterprises, especially in respect of their relation with the government, which is one of subordination. It is therefore not surprising that there are many disputes among Russian jurists on the question of juristic personality.

As to the practical working of the organisation of Soviet industry and trade and the appreciation of its costs to the Russian people no objective estimate is available, but we hear even from official or semi-official quarters of inefficiency and excessive bureaucracy. This is due to a large extent to the centralisation of the production policy and the supervision which hampers the initiative of managements and makes the whole overgrown machinery unwieldy. The only thing which can be said is that the organisation withstood the tremendous strain of the war, and

t may be that in the course of peaceful evolution better methods f co-ordination and management may be devised and put in ractice.

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PART II

Legal Problems of Private Corporations

CHAPTER I

LEGAL STRUCTURE OF PRIVATE CORPORATIONS

31. Capital and Shares

I. In connection with corporations, the word "capital" may bear several meanings. We may use it to describe a corporation's aggregate assets. More often it designates the monetary value of these without (gross capital) or after (net capital) deduction of debts.

In its legal meaning, capital is the sum contributed by the members for the corporation's purposes, and, with certain exceptions, maintained by it intact. In this legal sense the capital of a company (usually called "share capital" in Great Britain and "capital stock" in the U.S.A., *capital social* in France and *Grund-* or *Stammkapital* in Germany), is always a fixed sum of money, generally in the currency of the country where the company is incorporated. Its equivalent may be expressed in foreign currency also, but even then the expression of the amount in the local currency is decisive.

The word "capital" is often loosely employed, even in legislative Acts. Thus some American legislatures when dealing with the so-called excise tax imposed upon corporations, use the term "capital stock" to define the basis of taxation, when the real intention is to tax the whole of the corporation's capital assets, and several Courts have rightly held that in every Act the word is to be construed according to its context, as did the Supreme Court in regard to the Excise Tax Act of 1918.[1] Even the British Companies Act of 1929 uses the word in three different senses: to denote, firstly, the sum laid down in the memorandum as the authorised capital; secondly, the issued capital; and, thirdly, the amount of capital actually paid up.

Capital in the legal sense is contributed by the members who take proportionate parts in the corporation. These parts are the shares (called in the U.S.A. "stock"); the members are called "shareholders" (in the U.S.A. "stockholders"). In Great

[1] See Wright *v.* Georgia, 216 U.S. 420, Hecht *v.* Malley, 265 U.S. 144, and Ray Consol Copper Co. *v.* U.S., 268 U.S. 373.

Britain the term "stock" is reserved for use in a particular case (see para. III). The shareholders' contributions may take the form of money, property or services; but their value is always expressed in terms of money.

A share therefore represents a certain part of the capital, and in most cases its nominal value is expressed as a sum of money equal to the fraction of the total capital in question. Thus if a corporation has a capital of £100,000 divided into 100,000 shares, a share represents one hundred-thousandth part of this capital, i.e. £1. This sum of £1 is the nominal or par value of the share. Until 1912 a share (stock) had usually a stated par value; thereafter certain legislative systems evolved a new device, the share with no par value, which will be discussed later.

II. The capital in this legal sense is therefore to be distinguished from the assets of the corporation, which are frequently called capital assets. Such assets may consist wholly or partly of money; but it is quite exceptional for them to be entirely in money. They may be so at the formation of the corporation before its business activities have begun; but not if the members' contributions wholly or partly take the form of property or services.

Every business corporation must have a capital, but under some legislations this fact is obscured by technicalities.

English Company Acts have always been so drafted as to include corporations with no share capital, i.e. those with other purposes than to carry on a business and earn profits. Some companies without share capital are on the register; they are mostly non-business associations, and with such we are not here concerned.

The capital is fixed by the company's constituent document, i.e. its memorandum of association (certificate, or articles of incorporation), and must be a stated amount in money. Legislative systems which have no special rules for co-operatives are necessarily more lenient in this respect, since for these it is essential that the members should not be permanently tied to them, but should be able to leave them if they so wish—at any rate after a certain time. The type of corporation with which this work deals, and which many legislations, including all those of the European Continent, treat as a separate class, is the business corporation, the company proper, which has always a certain fixed capital.

This principle, however, has two exceptions. It is not everywhere required that the entire capital should be in existence, that is, created or issued, from the start. Anglo-American law requires only that the maximum amount of capital which the corporation is permitted to possess, the authorised capital as it is called, be determined. It may be put at the disposal of the corporation gradually; the corporation at its creation may have an issued capital of less amount than the authorised capital. Continental legislations, on the other hand, maintained the rule that the capital as originally fixed must be issued in full. It was only in 1937 that German Company Law allowed, with certain limitations (see § 23), the subsequent creation of capital up to a maximum fixed by the articles.

The other qualification is that it is nowadays universally recognised that the capital may be increased or reduced by a voluntary act of the corporation, usually a resolution in general meeting. This was not always so; it was formerly held that the capital could not be increased or reduced beyond the amount fixed in the memorandum or articles, or could be so increased only with the consent of the legislature or executive.

The capital of a corporation is assumed to be and should as a rule be at least equal to the net monetary value of its assets, i.e. to their aggregate value less debts and other liabilities, in so far as they are capable of estimation in money. If their value is less than the capital, a deficit exists which is regarded and treated as a loss, no matter whether it originates from adverse business operations or from depreciation of assets. If the net value of the assets is greater than the capital, there is an excess, which may be the result of favourable operations, in which case it represents profit, or may be part of earlier profits that have been held back, in which case it is a surplus or reserve (see § 32). Such surplus may in some cases arise from a premium paid by members; this case will be discussed below, para. III.

Complete equality between the amount of the capital and the net monetary value of the assets is hardly conceivable, except at the moment of the company's formation. Thereafter the position must necessarily change as a result of its transactions: if these are favourable the value of the assets will increase; if adverse, it will decrease. Again, the value of the fixed assets acquired may increase or decrease; such changes, indeed, are unavoidable, and therefore equality will hardly ever be found.

Even for the time of formation, two important qualifications must be made. The first is that absolute equality can hardly exist where the whole or part of the capital takes the form of property or services. In such a case its value is a matter of estimate, and no estimate can be absolutely exact. If on the other hand the capital is contributed entirely in money, the aggregate contributions may be less than the capital. The shares may be issued below par, either directly, so that the subscribers pay less than their par value, or indirectly, by granting commissions to promoters, bankers or other persons, or allowing for payment of the expenses of promotion. In earlier days issues below par were fairly common; and as a consequence over-capitalisation occurred. Conspicuous cases of such issues were met with in connection with American railways, and it is on record that the public could easily be induced to take shares whose par value exceeded the actual amount paid. Legislation now tends to prevent issues below par, especially at the formation of a corporation, and also by limiting commissions. The same trend appears when capital is increased by the issue of additional shares. But there are considerable differences between the various company legislations, which we shall examine elsewhere.

It is everywhere held as normal and desirable that at the time of formation the net value of a corporation's assets should be equal to the capital as fixed by the memorandum or articles, and to this end rules have been nearly everywhere evolved to prevent, or at least to restrict, issues below par. Even more important is it to secure that in the case of issues for property or services the par value of the shares given to the transferors should not exceed the fair value of the consideration. It is sometimes sought to attain this end by prescribing special machinery for previous valuation; in other countries steps are taken to establish the liability of promoters, directors and shareholders who take part in the issue of watered stock or who gain by allotment of such shares (see § 45).

After incorporation the company must refrain from any distribution or repayment to shareholders unless it is effected by special machinery and in compliance with the rules governing repayments of capital. This is usually expressed in the rule that the corporation must preserve its capital intact, with the qualification that against diminution by losses there are no legal guarantees. It is obvious that the formulation as suggested is more exact, and

the care and diligence in management required from directors should give protection from loss. Another expression of the rule is that the capital is a "trust fund" for the benefit of creditors. This also is inexact, since technically it is not a trust fund, and the rule as formulated is to the benefit not only of creditors but also of shareholders. Moreover the capital is not a debt of the corporation, and it is only from expediency that it is counted among the liabilities. In many legislative systems this is expressly provided.

As said above, distributions of dividend may be made only from profits. A natural consequence of this principle would be that losses likewise should be made up from profits. But this principle is not everywhere accepted, particularly by Anglo-American law.

III. The capital of a corporation is invariably divided into parts called shares or stock. Under most legislations the share has a par value equal to the fraction of the capital which it represents. The articles may fix the number of parts, and thus the par value also. The shareholder, on the other hand, has no power to make further divisions. In this sense the shares are indivisible. But a share may be the joint property of two or more owners, in which case they will exercise jointly the rights attached to it.

It must be stated, though a truism, that a share gives no right to a part in the property of the corporation, and a shareholder is not a joint- or co-owner of the corporate property. The contributions of the shareholders, whether in money or other property, become the exclusive property of the corporation, the shareholders being entitled only to dividends and to distributions on reduction of capital or liquidation.

Since the capital is not a debt of the corporation and the shareholders are not its creditors, they have no claim to either interest or repayment. There are, however, exceptions in both directions: within fixed limits and for a certain period the payment of interest may be stipulated in the articles, and in some cases redemption of shares is possible. On the other hand the share carries certain rights in the administration of the corporation, especially the right to attend general meetings, to take part in the deliberations, to exercise a vote and within certain limits to inspect the books and records, to call for investigation, and to bring action against directors or officers. All these rights, though

inherent in the share, are in many respects regulated or restricted by statute. Furthermore, the possibility is widely recognised o excluding these rights by contract by inserting clauses to that effect in the memorandum or articles of association.

IV. Shares as a rule give equal rights irrespective of their date of issue without seniority as between different issues of shares.

Originally corporations could not issue shares with differing rights. When shares had different par values the rule was that they give proportionate rights, whether to dividends, to quotas in distributions of capital or to votes. Financial technique, however, has evolved shares with differences in rights, and the issue of shares with preferential rights has become popular. We meet nowadays with "preference shares" carrying preferences of various kinds over the common or "ordinary" shares, sometimes called deferred shares. On the other hand preferences may be offset by limitations under the articles; for example, preference shares may be excluded from participation in profits or distribution beyond a certain limit. So-called non-participating shares of this type are fairly widespread. Discrimination may also be made in respect of voting rights: in earlier times preference and ordinary shares as a rule had equal voting rights, but it is usual nowadays for preference shares to carry no vote at least so long as the dividends they carry are paid (§§ 61, 72, Vol. II).

V. Capital as a technical term of economics may be used to include capital assets acquired with sums lent to the company, and it is usual to speak of capitalisation as covering both the share capital and the bonded debt of a corporation. Legally, however, bonds and debentures are debts of the corporation and not part of its capital. We shall, therefore, discuss them separately.

32. Share Certificates

It is an almost universal practice for corporations to issue written acknowledgments of the shareholders' interest, or "share certificates" as they are called. Consequently the word "share" or "stock" is frequently used to denote this certificate itself. Under English law the articles may provide that no share certificates are to be issued, the share ownership being merely recorded in the company's books. We then speak of stock instead of shares.

Share certificates under English law are either registered—

i.e. issued in the name of the shareholder—or share warrants to bearer. In the former case the ownership is evidenced by the name of the owner being shown on the certificate and registered in the books of the company. In the case of bearer warrants the holding of the certificate is the evidence of ownership.

Correspondingly, the transfer of registered shares is made by an entry in the company's books, and no such entry can be made except on production of the certificate and a declaration executed by the transferor or former owner, and the transferee or new owner of the share. In the case of warrants to bearer possession of the certificate is proof of transfer.

A British company issuing bearer warrants usually has registered shares also, and each kind is convertible into the other at the holder's option.[1]

In the U.S.A. a corporation is not compelled to issue share certificates. But if the articles (certificate of incorporation) so provide, the shareholder is entitled to request the issue of a certificate. All legislations in the U.S.A. require that share certificates shall contain the name of the holder; bearer shares or warrants are not admitted.

The share certificate is merely evidence of the share, and not the share (stock) itself.[2]

It has been said that "a share of stock in a corporation consists of a set of rights and duties between the corporation and the owner of the share. These rights and duties are in fact and law quite distinguishable from the certificates and the power to transfer those rights and duties. The certificate is evidence that the person named therein possesses those rights and is subject to those duties, but is not in law the equivalent of those rights and duties. They are muniments of title but not the title itself." [3] The same applies to interim certificates retained in the custody of the corporation.[4]

A subscriber to the capital of a corporation becomes a stockholder as soon as his subscription is accepted, provided the statutory or charter conditions are performed, whether a certificate is issued or not.[5] The same applies to a purchase subsequent

[1] Sec. 70 of Act of 1929; Sec. 83 of Act of 1948.

[2] McAllister *v.* Kuhn, 96 U.S. 87; Cecil Nat. Bank *v.* Watsontown Bank, 105 U.S. 217; Pacific Nat. Bank *v.* Eaton, 141 U.S. 227; Citizen *v.* Illinois, 205 U.S. 46; Richardson *v.* Shaw, 209 U.S. 365; cf. Fletcher 5092, Ballantine, § 198.

[3] Winslow *v.* Fletcher, 53 Con. 390, quoted Fletcher 5092, n. 91.

[4] See Pacific *v.* Eaton, *supra.*

[5] See South Dakota *v.* North Carolina, 192 U.S. 286.

to the formation of the corporation. This Federal rule is accepted by most American State Courts.[1]

In purchasing shares, a distinction is made in cases where the contract is executory. In such cases property in the shares is not deemed to have been transferred so long as the contract is not executed. In other words, in the case of a sale, the property in the share is transferred by the contract, whereas in the case of an agreement to sell—to use the terminology of the English Sale of Goods Act—the purchaser does not by the agreement itself acquire property in the share.

Shares are personal estate in Great Britain (sec. 73 Companies Act) and in the U.S.A. they are regarded as personal property even where the property of the corporation consists of real estate, unless the contrary is provided by statute.[2] This has been recognised by the U.S. Supreme Court in various cases,[3] though in some of the States special statutes declare the shares of certain classes of corporations to be real property. Consequently the rules of personal property apply to the sale, pledging or other alienation of shares, and also to their bequest and devolution by intestacy. Under common law it has been held that shares cannot be subject to execution, attachment or garnishee. Even to-day it is held that in order to subject them to such proceedings there must be statutory authority. This follows from the doctrine that shares are choses in action, which being intangible and incapable of manual seizure and delivery cannot be taken in execution.[4] To-day, however, in most if not all the States of the U.S.A., statutes provide that shares in corporations shall be subject to execution or attachment for the holders' debts;[5] furthermore in a number of States shares have been made subject to garnishee. Apart from the question of executions it has been recognised that a Court of Equity may set aside a transfer of shares made fraudulently by the holder with intent to defraud the creditors. But in some States this rule is held to apply only if a remedy in equity is provided by statute.[6] The Uniform

[1] Fletcher 5094, n. 15.

[2] See Van Allen *v.* The Assessors, 3 Wal. 573; People *v.* The Commissioners, 4 Wal. 244, and the State Decisions quoted by Fletcher 5096, n. 30.

[3] Tappan *v.* Merchants, 19 Wal. 490; Morgan *v.* Struthers, 131 U.S. 246; and Hawley *v.* Malden, 232 U.S. 1, and further the State Decisions quoted by Fletcher 5096, n. 38.

[4] Fletcher 5103, n. 51.

[5] See Jellinek *v.* Huron, 177 U.S. 1; Yazoo *v.* Clarksdale, 257 U.S. 10; and the decisions in Fletcher 5104, n. 56.

[6] Fletcher 5105, n. 84.

Stock Transfer Act provides that a creditor whose debtor is the owner of a certificate is entitled to such aid from the competent Courts by injunction and otherwise in order to attach the certificate as is allowed at law or in equity with regard to property which cannot readily be attached or levied upon by ordinary legal process (sec. 14). Consequently the shares may be sold at a judicial sale. They may be seized under the Trading with the Enemy Act.[1] In accordance with this principle shares may be the subject of conversion and an action of trover, whereas under the early Common Law the rule was to the contrary.

The rule generally accepted (the New York rule) is that the proper measure of damages in case of conversion is the highest intermediate value of the stock between the time of conversion and a reasonable time after the owner has received notice thereof to enable him to replace the stock.[2] The question of damages is one not of corporation law but of the general law of damages, and does not here concern us.

Under European Continental legislative systems the shareholder has the right to request the issue of share certificates, unless that right is excluded by the articles. They may be nominative, i.e. issued in the name of the shareholder, or to bearer, as the articles may provide. The German Company Law (sec. 17) provides that if the articles do not provide otherwise they are to be nominative; other laws require the articles to regulate this question. A company is generally allowed to have both nominative and bearer shares simultaneously, and a shareholder to convert his nominative into bearer shares or *vice versa*.[3] The issue of bearer shares was until recently paramount on the Continent.

It is usual to attach coupons to the share certificates entitling the holder to draw dividends for a certain period, and these coupons under Continental law are as a rule drawn to bearer even when the shares are nominative, as is the document ("*talon*") entitling the shareholder to receive new coupons after the exhaustion of those originally issued.

Where there are nominative shares, there must be a special register of members, called on the Continent the "share book", for the registration of the shareholders and recording of transfers.

There is a fundamental difference between Anglo-American

[1] See Stöhr *v.* Wallace, 255 U.S. 239; Great Northern *v.* Sutherland, 273 U.S. 182.

[2] See Galigher *v.* Jones, 129 U.S. 193, and the State Decisions, Fletcher 5117, n. 65.

[3] Germany, C.L.S. 17 (2); Swiss O.R., s. 622, 626 (3), 627 (7).

and European legislations in the character of the share certificates. By the former they are regarded merely as documents of evidence, not as negotiable instruments. This means that the ownership is not incorporated in the instrument, which is only to facilitate evidence. Under English law transfer of ownership has to be made by a special declaration, a conveyance of the property. In the U.S.A. generally the share may be transferred by an endorsement, even by a blank endorsement, in which case the possessor of the certificate is entitled to insert his own name in it. In neither case is the company under the duty to require further evidence, though it is entitled to do so. In the case of forgery or invalidity or voidance of the declaration (in the U.S.A. of the endorsement) difficult questions arise. In most cases the company is entitled to require some guarantee or security, if the certificate is not produced.

European legislations generally regard the certificate as a negotiable instrument. If drawn to bearer it is a bearer instrument (*Inhaberpapier*), if registered, is usually an *Orderpapier*, i.e. negotiable by endorsement. In the case of bearer shares possession of the certificate legitimises the possessor as owner, and transfer of the share is effected by its delivery. If the certificate has been delivered without a valid act of transfer, the legitimate owner is not as a rule entitled to assert his ownership against a third party who has acquired it in good faith.

Transfer of ownership of a nominative share is effected by endorsement, unless the articles provide to the contrary, and blank endorsements are allowed. The provisions of the Law on Negotiable Instruments, especially of Bills of Exchange, apply to endorsements. This means that if the endorsements are formally in order the last endorsee acquires ownership. The company is not bound to inquire into the genuineness or validity of the endorsement against an endorsee in due course, and if it objects to the title it must prove bad faith in order to succeed.

The *talon*, a sheet containing dividend coupons for a number of years, e.g. twenty or more, and entitling to the issue of new coupons, is usually drawn on the bearer. Dividends are generally paid against the coupons; production of the certificate is mostly not required, and the company is not in a position to pay the dividends only to the persons registered in its books. It therefore happens fairly often that the company's share register does not reveal the actual ownership of the shares. They are transferred

by endorsement; ownership is often changed by the use of blank endorsement and simple handing over of the endorsed certificate. Consequently one blank endorsement makes possible a large number of transfers without any outward sign of the change. It is therefore only a shareholder who is interested in some way in the conduct of the company's affairs, and intends to appear at general meetings, who applies for the entry of his ownership in the register. In view of this state of affairs, the difference between bearer and registered shares under the German and German-influenced legislations is not so substantial as might be supposed.

Nevertheless there has recently been a marked trend towards abolishing bearer shares and making registration compulsory. This movement finds strong support from considerations connected with the taxation of dividends.

In regard to both bearer and registered shares European legislation provides, in the event of destruction or loss of the certificate, for special measures to preserve the ownership of the shares and the exercise of the rights attached thereto. Generally application has to be made to the competent Court, accompanied by *prima facie* evidence of the former ownership and some probable account of the loss or destruction of the certificate. The Court then issues an order, to be published in the official Gazette, summoning the possessor of the share to appear before it within a certain time and to assert his rights. If the possessor appears, proceedings are suspended and the applicant has to assert his rights by an action in the ordinary course. In the suit thus arising he must give testimony according to the general rules with regard to the onus of evidence. Should he prevail, the company has to issue a new certificate in his favour. The same is to be done if no possessor comes forward during the prescribed term.

Lost coupons cannot as a rule be claimed in this way, at least not until after the period of limitation, which under the legislative systems in question is generally a short one.

English Company Law, as already mentioned, recognises bearer warrants; it maintains, however, that the certificates are only evidence of holding, and are not the shares themselves. There are therefore no special rules for the event of their destruction or loss. It is for the company to require such security from the shareholder as it may think fit; the Court may interfere only

if the security so required is unreasonable. In practice, companies require a bank guarantee, generally one covering a long period. This involves hardship, especially for shareholders in restricted circumstances. In consequence, the shareholder is in a less favourable position under a legislation, which regards the certificate merely as evidence, than under one where the ownership is deemed to be incorporated in the certificate. It is therefore advisable to establish an adequate procedure for the replacement of the certificate in the event of its loss or destruction.

The further question arises whether bearer shares should be allowed at all. Certificates of this kind, as already remarked, became very usual in Europe, especially in Germany and all countries under the influence of German law, such as Austria, Czechoslovakia, Hungary and Rumania. They are found in France and in Switzerland also, but perhaps to a lesser extent. During recent years there has been a distinct movement to restrict their use. In Italy, a law of 1940 provided that bearer shares should not be issued, and that existing bearer certificates should be converted into registered shares. The Vichy Government legislated in the same sense, with the qualification that bearer certificates already existing were not to be converted compulsorily into certificates in the holder's name, but if not so converted they were to be deposited with a bank. At present it is not clear whether these laws will be maintained by democratic governments in the States concerned, though it is probable that some restrictive measures will in due course be adopted.

It is undoubtedly true that bearer certificates are a great convenience to the public, and conveniently meet the exigencies of Stock Exchange transactions. They are more easily marketable, and therefore as a rule fetch a higher price. The price difference will be slight so long as registered shares are convertible into bearer shares at the holder's choice. But if such conversion is not possible either under the articles or by virtue of a general law, as was the case under the Defence (Finance) Regulations in Great Britain, the difference may be higher. Thus in December 1945 bearer shares of the Abukir Company were quoted at 45*s.*, registered shares a short time earlier at 30*s.* 6*d.*, and a price offer of 40*s.* was held to be fair.[1] On the other hand concealment of ownership is much more simple. It is very easy to arrange an attack on the management by depositing without warning a

[1] *The Times*, 15 December 1945.

substantial block of shares for a general meeting and thus taking the board, which has had no time to organise the defence, by surprise. By such surprise attacks a minority may act as a majority at the meeting, and exercise control, at least for a time. Another drawback is that speculation by directors, other officers, or shareholders, based on inside information, is in this way facilitated. The American practice, which admits only registered shares, is therefore to be preferred.

A share, like any other property, may be the subject of a trust, and the legal ownership may be separated from the beneficial interest. If one or several shares are vested in a person who has no other function than to appear on the company's register and on the certificate, he is called a nominee. The company has no knowledge of the beneficial owner; it knows only the nominee. Generally it is the nominee who receives the dividends and pays them to the beneficial owner.

English legislation goes so far as to prohibit the acknowledgment of any trust in respect of shares. Other systems, e.g. the law of Scotland and that of many of the States of the U.S.A., recognise the possibility of a trust, and do not compel the company to abstain from dealing with a trustee or nominee. In the case of bearer shares a similar position may arise, but then all rights may, of course, be exercised on production of the certificate without need of further legitimation.

The device of nominee holdings works in a similar way to the bearer certificate, and its wide use is easy to understand. In Great Britain there are many companies specially organised to hold shares for their clients and to act as nominee on their behalf. Each of the large banks has at least one nominee company for the service of its clients. Several witnesses gave evidence before the Cohen Committee regarding the use of nominee companies. Further it is well known that private companies also hold substantial blocks of shares for other persons. In the U.S.A. there are trust corporations which exercise the same function.

All the objections to bearer shares are equally valid against nominee holdings. In view of the dangers connected with such holdings, and especially of the possibility of concealing foreign ownership and control by their means, there is a strong feeling against them, especially in Great Britain. This feeling is crystallised in the demand for a compulsory disclosure of nomineeship.

33. Size of Capital and Shares

I. MINIMUM CAPITAL

In earlier days none but enterprises of considerable size aimed at incorporation, and therefore most legislative systems did not concern themselves with the formation of small companies. But time brought a change, and with the invasion of all branches of industry and commerce by corporations, the company registers of many countries are now filled with the names of companies with a small capital. This became even more true when the creation of private companies was rendered easier, as it was especially in Great Britain by the Companies Act of 1908. Companies with a capital of £100 are numerous nowadays, and instances exist of an even smaller nominal capital. Before the Cohen Committee companies with a capital of thirty shillings, and one with a capital of only two shillings were mentioned as extreme cases.

It is obvious that the registration of such companies, and the work it imposes on those entrusted with the administration of company affairs, causes much trouble which is not adequately compensated by the fees provided for by the company laws. More important, the formation of companies with a small capital but with limited liability may deceive third parties, who necessarily attribute to a company some measure of sound financial status, even if the company's name is in no way misleading and does not suggest a large enterprise. While it is true that any prospective creditor can get information about their financial status, it is questionable whether the formation of companies with less than a certain minimum capital should be permitted. At present British Company Law lays down no specific capital minimum, but there are some classes of enterprise for which a specific minimum is prescribed.

Most American legislations refrain from requiring any minimum, and the incorporators are therefore free to fix the capital of the corporation. Even where State legislation does fix a minimum, it is not substantial. It varies from $200 in Georgia to $2000 in Alabama, Missouri, New Jersey and New Mexico. Arkansas requires $300; Ohio, Pennsylvania, Vermont and Washington $500; Louisiana, Maine, New Hampshire and Tennessee $1000. In view of the smallness of these minima the freedom of incorporators is practically unrestricted.

The laws of the European Continent until the present century gave companies full freedom to fix their capital as they chose. There was, however, an indirect limit where minima were prescribed for shares. Thus in Germany after 1897 the shares had as a rule to be of a par value of at least M1000 each. Since five incorporators at least were required, no company could be formed with a lesser capital than M5000. After the introduction of the G.m.b.H. in 1892, German companies as a rule had fairly large average capitals. In other Continental countries the law either fixed no limit, even indirectly, or required very small minima.

The depreciation of Continental currencies after the First World War extinguished the value of nominal capitals. In Germany, after the inflation period ended and the capital of even the largest companies as laid down in their articles had become practically nil, the law had to provide for capital readjustments and revaluation of assets in the terms of the currency as finally stabilised. The ordinance of 28 December 1923 on gold balance sheets fixed the minimum capital for existing companies at M5000 (£250 or $1250), and in the meantime provided that new companies could not be created with a smaller capital than M50,000 (£2500). Formerly the minima were M500 and M5000 respectively.

The German example was followed elsewhere: Hungary, for example, in connection with the stabilisation of its currency in 1925 prescribed that new companies could not be registered unless they had a capital of not less than Pengö 150,000 (about £5500); for companies of local interest a minimum of Pengö 50,000 was required.[1]

German law, however, was not satisfied with the minimum requirement of 1923. It was stressed more and more that the legal company form (A.G.) was to be reserved for large enterprises. Smaller enterprises should take the form of a partnership or a G.m.b.H. Consequently the law of 1937 provided that existing companies must have a capital of at least M500,000, although the Government could grant exceptions (sec. 7).

The Swiss Law of Obligations (O.R.) provides that the capital should be at least Swiss Fr. 50,000 (sec. 621).

All the legal systems which demand a minimum of capital require, of course, that that minimum shall be fully subscribed,

[1] Ordinance 7000 ex 1925.

and there is invariably a rule requiring some part of it to be paid in. This is sometimes effected by enacting simply that the capital paid in should reach a prescribed minimum—as under some American legislations—or else by requiring that a percentage should be paid on each and every share. This is the case, for example, under the German law, where at least 25 per cent. must be paid; in Switzerland, where the percentage is 20, with the qualification that the sum paid in must not be less than Swiss Fr. 20,000; and in Hungary, where at least 30 per cent. has to be paid in in order that the company may be registered. On the other hand no limitation, direct or indirect, exists in Great Britain, nor even a provision that a quota of the authorised capital must be subscribed. The position is the same under most of the U.S. State legislations.

II. SIZE OF SHARES

Under English law a company has full freedom to fix the par value of its shares. This has led to the issue of shares of small denominations; 2*s*. and 1*s*. shares are quite popular, and there is one case of a mining company which had a nominal capital of £40,000, with 9,600,000 shares each of 1*d*. There would be no legal obstacle to the creation of a public company with a capital of 7*d*. or a private company with a capital of 2*d*. This was not always so: until the middle of the 19th century £10 shares were quite normal, and £1 shares the general minimum. For joint stock banks the Act of 1844 (7 & 8 Vic., c. 113) prescribed a minimum of £100.

Many Continental legislations now require a minimum par value for shares. Thus under German law, after the stabilisation of the currency, the minima were reduced to a tenth of the amounts previously established, i.e. to M100, or in privileged cases to M20. The law of 1937 restored the old minimum, and thenceforward shares were as a rule to have a minimal par value of M1000. The Government, however, could grant exemptions, and could authorise the issue of shares of smaller par value, though not under M100 (sec. 8).

Under Swiss law no share may have a par value of less than Swiss Fr. 100 (sec. 622 (4)). In case of a reconstruction necessitated by losses, the par value may be reduced below the minimum.

From the point of view of legislative policy it is not advisable to allow quite insignificant ventures to make use of the corporate device. The requirement of a minimum capital therefore is undoubtedly reasonable. What that minimum should be depends upon the economic and financial circumstances of the State in question. The minimum of \$5000 accepted by some American legislations seems adequate, and for Great Britain the writer would favour a legal requirement of a £500 minimum capital, of which not less than £100 should be payable before registration.

The requirement of a minimum size of share is directed to deter persons of small means from investing in shares, and in general to reduce gambling in stocks. It is important, on the other hand, to make possible a widespread collection of disposable capital. The minimum fixed by, e.g. German legislation is obviously too large, and helped to explain the growing lack of interest on the part of the general public in investment in corporate securities. But complete freedom also has its drawbacks. Small shares may undoubtedly attract inexperienced persons who do not appreciate the risks of a given enterprise, and may easily be deceived by fraudulent schemes. In the case of sound enterprises, however, small shares are not convenient for technical reasons. Thus if a company with a capital of £100,000 issues 1*s.* shares, it would have two million of them, and even if we assume a certain number of large holdings, holdings of five or ten shares remain possible. In this way a company with a relatively small capital might have shareholders to the number perhaps of tens of thousands. This would impose upon the company not only much work, but also substantial expense. The fixing of a minimum is therefore advisable. To its amount the same considerations apply as to the minimum of capital: for Great Britain a minimum of 10*s.* would not be unreasonable. In some of the United States there is already a minimum of \$5.

34. Reserves

If the monetary value of a corporation's assets exceeds its capital, the difference is the reserve, often—especially in the U.S.A.—called the surplus.

It is very exceptional for the amount of the surplus to be administered separately, and therefore to be represented by

particular assets; generally it is merely an item of accounting. It is otherwise in the case of insurance companies, where the reserves, or some part of them, form a provision for contingencies arising out of the policies. These reserves affect the interests of the policy-holders, and for this reason both sound financial policy and, under many legislations, the law also, prescribe their administration as separate funds, require them to be invested in particular ways, and so on. Special questions also arise in respect of pension and similar funds. Apart from these cases the reserve is not a distinct asset or aggregate of assets, but is the excess of the monetary value of the corporation's assets over its liabilities and capital, and is placed in the balance sheet among the liabilities as a separate item.

The origin of the custom of building up reserves is closely connected with the idea of the permanent existence of corporations as business units, and with the practice of retaining the capital for so long as they exist. So long as corporations undertook single ventures whose results were distributed when the venture concluded, as in the early days of the East India Company, there was no need for any reserve.

After the establishment of the "permanent stock" under charters the rule was that distributions might be made only from profits without impairing the capital. It was the practice, however, to distribute the whole of the profit. This had the disadvantage that dividends varied with profits, and that in bad years no dividends at all could be distributed. Shareholders could not reckon on a constant income from dividends, and the market price of shares was largely influenced by the short-term dividend outlook. This situation was necessarily awkward for a careful management, and the practice therefore arose of setting aside for rainy days a part of the profits in prosperous years. A conspicuous and illustrative evolution of this practice is seen in the Bank of England, whose by-laws prescribed at a relatively late date the formation of a reserve, the so-called "Rest".

Such a reserve, frequently called a general reserve, has two functions. It may be used to supplement the amount available for dividends from current profits, and also to replace the amount lost in bad years, so that the capital of the company may remain intact and the resumption of dividends in later years be possible. The principle is obviously the same in both cases.

The initiative for the establishment and strengthening of

reserves always came from the management; directors and shareholders as a rule acquiesced, but often with much grumbling.

The French Company Law of 1867 (art. 36) prescribed the formation of a reserve; 5 per cent. of profits were to be set aside until the reserve reached 10 per cent. of the capital. The articles might provide for a larger, but not for a less provision, and the reserve could be used only to balance losses, and not for paying dividends. It therefore became usual to form a separate reserve to provide for dividends, a so-called "free reserve". The French example was followed by many other legislations, especially on the European Continent, but Anglo-American law contains no compulsory rules, and it is left to each corporation to provide for reserves and to define their purpose.

Balance sheets of business corporations in both Great Britain and the U.S.A. show considerable reserves for a great variety of purposes. Beside the general reserve, which has as a rule the twofold purpose of providing for dividends and restoring the capital when diminished by losses, there are reserves for strictly circumscribed special purposes, such as the erection of new plant, or reconstruction.

Many balance sheets contain items which are called reserves, but are not in fact reserves at all. Thus in many cases provisions for contingencies, whose occurrence and amount is at the time uncertain, are so named, and likewise depreciation of assets is frequently provided against not by writing them off on the debit side of the balance sheet, but by a credit item known as the reserve for depreciation, obsolescence, or by some similar name. So long as such items do not exceed the amount needed for the contingency in question, they are not reserves, but corrections of the valuation of assets reckoned on the active (debit) side of the balance sheet. They may, of course, contain a certain element of reserve, e.g. if the contingency is non-existent or is less in amount than the sum earmarked. To that extent they are real reserves, and, in contrast with the stated or open reserves, are "secret" or "hidden" reserves.

The formation and use of reserves involves many questions, especially as to accounting, the rights of shareholders, and dividends. These will be discussed in §§ 58–84, Vol. II.

Reserves may, however, originate not only from profits but also from share-premiums paid in by subscribers on the formation of a company, or for shares taken up in connection with increases

of capital. Sound finance requires that such premiums should be excluded from distribution and should be treated in the same way as reserves, with the exclusive purpose of replacing capital lost in the course of business. They are therefore sometimes called "capital reserves".

Some legislations, especially the German, prescribe that share premiums must invariably be put into legal reserve.[1]

The Companies Act 1947 (sec. 72), following the recommendations of the Cohen Committee, provided that where shares are issued at a premium, whether for cash or other consideration, a sum equal to the aggregate amount or accounted value of the premiums is to be transferred to a separate "share premium account", which is to be shown in every balance sheet of the company. These amounts are to be treated from the standpoint of a reduction of capital as if they were paid-up share capital. None the less they may be applied by the company to pay up unissued shares, to be distributed among the members as fully-paid bonus shares, to write off preliminary expenses and the expenses of any issue of shares or debentures by the company, or commissions paid or discount allowed on such issue. They may also be used to provide for premiums payable on redemption of the company's redeemable preference shares or debentures.[2]

35. Contribution and Liability of Shareholders

Limited liability is nowadays a conspicuous characteristic of corporation law. As we have seen in Part I, this was not always the case, and in the days of chartered companies limited liability was a privilege granted in exceptional cases only. Even so, it was only liability as against third parties which was limited, the company having power to make calls or assessments and thus to compel its shareholders to make further contributions. The principle of limitation of liability to the shareholder's contribution, or in other words to the payment of the par value of the shares taken up by him, grew up slowly, and not without strong opposition, as a rule of general corporation law. Even nowadays it is not without exceptions.

English Company Law leaves it to the company in every case to decide what liability its shareholders shall accept. A company

[1] § 130 (2), law of 1937.

[2] Sec. 56, Comp. Act, 1948.

may be created with either unlimited or limited liability. In the latter case, the articles may provide for a limitation by guarantee; this guarantee may consist in a fixed sum of money, or in a multiple of the par value of the shares, or the liability may be restricted to the contribution, in which case the company is called by the Companies Act a Company Limited by Shares.

Under English law, therefore, companies have very wide powers to fix the liability of their members, and liability limited by shares is only one of several alternatives. In fact, however, the overwhelming majority of companies in Great Britain are companies limited by shares, and both liability and contributions are limited to the par value of the shares.

A different view is taken by European legislations, which are in general agreement that a company proper (*Société anonyme*, *Aktiengesellschaft*, etc.) cannot be created without the liability of shareholders being limited to the par value of the shares and *per accidens* to the premium, if it is so stipulated at the formation of the company for the original issue, or at a subsequent increase of capital by the issue of additional shares. This attitude is due to the influence of the Napoleonic legislation, as the *Code de Commerce* was the first system to introduce limited liability as a fundamental and general rule of company law.

European legislation looks upon limited liability not only as a general characteristic of companies but even as one which does not allow of exceptions. It is generally agreed that the articles cannot provide for a liability in excess of the par value, and a clause increasing liability above that limit would be void. There are, however, some exceptions. Certain legislative systems allow shareholders to be obliged to replace losses by additional contributions.[1]

The Norwegian law of 19 July 1910 (sec. 5, § 8) permits the articles to regulate the question of liability as the company chooses. The same is true of Sweden, where until recently banking companies generally had articles providing for a liability exceeding the par value of the shares.

It is to be remembered that most Continental legislations provide for special corporate structures for certain enterprises with special requirements. Both German and French law, and all legislations under their influence have special regulations for co-operatives, which in Germany are called "Fellowships" for

[1] Sec. 158 (5), Italian C.C.

common earning or husbandry (*Erwerbs- und Wirtschaftsgenossenschaft*), this name emphasising the intimate character of the corporation, whereas the French name "companies with variable capital" (*société à capital variable*) stresses the possibility of terminating membership by notice, which all Continental legislations accept for this type of corporation. Co-operatives may be created with either limited or unlimited liability; the limitation may even be to the par value of the shares subscribed.

Even for companies proper Germany has evolved a special structure: the company with recurrent contributions. The prototypes of these companies were the beet-sugar factories. The sugar-beet producers of certain districts joined forces to erect factories in which the beets they produced were to be transformed into raw sugar. To this end joint-stock companies were created with a capital estimated to suffice for erecting the factory and purchasing the equipment. This capital was to be raised by the beet producers, who subscribed and paid for shares proportionate to their agricultural holdings. Beside this contribution in cash the producers had to agree to deliver sugar beets to be processed in the factory. Since the German Commercial Code of 1862, and likewise the Company Law Amendment of 1884, recognised no other contribution in the case of joint-stock companies than the payment of the shares subscribed by the shareholder, the producers and the factory, i.e. the company, had to make contracts for the sale of the beets the shareholders should produce. This was done under various forms: the shareholders might undertake to put a certain area under beets and deliver the whole crop to the company, or to deliver a certain quantity of beets, say, 5000 cwt., whatever the area cultivated. In order to ensure delivery, it was usual to make the transfer of shares, except by inheritance, dependent on the company's assent.

In course of time many disputes of various kinds arose between the manufacturing companies and the producer-shareholders. If the market for sugar became depressed, and the price of beets had to be reduced, it was often disadvantageous to produce the beets, and there were cases in which the legal enforcement of the contract ruined the producer. He would then try to free himself from his obligation by sale and transfer of the shares, which the company of course resisted. In some cases producers tried to free themselves by abandoning their shares.

The German Courts treated the undertaking to produce and

deliver beets as a contractual obligation, and applied to it the rules governing the law of contract. Prominent industrialists and lawyers opposed this view, maintaining that the two relationships, namely, the holding of shares and the production and delivery of beets, were in fact a single obligation forming one and the same contract. In this view it is the membership of the company that alone matters, and the obligation to deliver the beets cannot be separated from the ownership of the shares. In practice, this amounted to a denial of the possibility of dissolving the contract without the company's assent. The Commercial Code of 1897 (§ 212) accepted this doctrine, and thus from 1900 onward it became the law that companies may by their articles bind shareholders to make recurrent contributions, with the single limitation that a transfer of the shares—if approved by the company—ends such obligation. This example was followed in Austria by the Regulative of 1899 (sec. 30). Under this system sugar-beet producers who took shares in such companies were obliged to deliver their produce either for an indefinite time, or for a long period, i.e. 80 to 90 years, in either case without the possibility of freeing themselves by notice.

Everything was well organised until the outbreak of the First World War. The tariff legislation of Germany kept prices high on the home market, beet cultivation was profitable, and membership of the factory-companies was something of a privilege. Only very exceptionally would a shareholder have tried to dissolve the relation, and if he were obliged to sell his land, solvent and suitable purchasers for the estate and the shares quite ready to undertake similar obligations could always be found. In the very few cases in which disputes arose between the companies and shareholders, the Courts held that the contract was indissoluble. The Supreme Court [1] decided that abandonment of the shares was not admissible, and [2] that such contracts cannot be dissolved by notice on the part of one of the partners.

The agrarian crisis of the thirties, however, had far-reaching consequences, which were felt even in this field. In many cases the production of beet in the quantities stipulated was not only unprofitable but simply ruinous for the producers, while the companies, in order to protect themselves, were compelled to refuse assent to the transfer of the shares.

On the lines of the doctrine of *rebus sic stantibus* which German

[1] R.G.Z. 17, 3.

[2] R.G.Z. 88, 187.

Court decisions and legal literature increasingly adopted, it was decided [1] that the producer is entitled to give notice to dissolve the contract if to fulfil it would ruin him. This judgment dealt with the case of a G.m.b.H., but the same *ratio decidendi* applies to joint-stock companies. In the literature, Herzog [2] approves the decision, provided the shareholder could not free himself by abandoning the share. On the other hand Bergmann [3] points out that this practice would ruin the whole structure of the manufacturing companies, and that therefore the right of dissolving the contract should not be accorded.

The whole dispute arises from the fact that the joint-stock company device is not suitable for undertakings of this kind; they are rather a field for co-operatives (*Genossenschaften*) or possibly for G.m.b.H.s, both of which are more easily adaptable for such purposes. It is to be noted that German G.m.b.H.s, French *sociétés à responsabilité limitée*, and the similar institutions of other Continental systems allow of stipulations for contributions in kind, but no extension of liability in excess of the par value of the shares.

The position under American law is a very interesting one. The early chartered companies in most cases obtained by their charters limited liability. For banks alone was a stricter system demanded by public opinion, and this mainly in the interest of the holders of the notes issued by the banks. Just as in England, corporate banking was generally identified with the issue of notes, and it was felt that, in order to secure the payment of notes issued, bank shareholders should assume liability in excess of the par value of their holdings. State legislatures in the U.S.A. were influenced to some extent by the evolution of legislation in Canada, where the early chartered banks enjoyed limited liability under their charters, whereas banks not incorporated by charter had, of course, unlimited liability. The Privy Council resolved in 1830 that banks should not in future be created by charter or by letters patent except with twofold liability, i.e. the shareholders beside the payment of their shares had to assume a liability equal to the par value of their holdings. The new rules were introduced in 1841–2. The principle of twofold liability was maintained in 1850 by the Free Banking Act, and in 1870 by the General Bank Act.

In the U.S.A., however, the principle of twofold liability was

[1] R.G.Z. 128, 1. [2] Z.H.R. 97, 422. [3] 2 H.R. 99, 373–93.

accepted only slowly, and then not everywhere. The first Bank of the U.S.A. had limited liability, and several States adhered to this principle.

As we have seen above, Massachusetts in 1811 introduced the rule that in case of loss through mismanagement shareholders were under twofold liability. Disputes occurred over the application of this principle, and only in 1849 were shareholders of banks subjected to twofold liability. In the fifties several States, for example, New York, Michigan and Maryland, accepted the same rule, whereas in California State banks were under unlimited liability, and there were wide variations in other States.

Even the draft Bills for National Banks proposed only limited liability. Congress, however, adopted twofold liability, this provision of the National Banks Act of 1864 being due to the same John Sherman to whose initiative, rightly or wrongly, is attributed the Anti-Trust Act of 1890.

By the National Banks Act shareholders of national banks were under twofold liability, as the Act says, "equally, rateably and not one for another". The liability was to be exacted by assessment. Characteristically the Bank of Commerce of New York, at that time the most important bank, was exempt from twofold liability, although it became a National Bank.

State banks ceased to issue notes after 1866, in consequence of the tax imposed upon their issues, and therefore in those States which had adopted twofold liability only in respect of notes, such liability lost its effect. Nevertheless in the course of time many States adopted twofold liability for State Banks in respect of deposits and other debts and obligations. By 1930 there were only ten States whose statutes accepted limited liability for banking corporations, some by their constitution, some by their corporation laws. Colorado had threefold liability, and California unlimited but proportionate liability.

The law as to National Banks was amended in 1913 to provide that shareholders should be liable up to the full amount of their holdings beside the contribution of the par value in so far as the payment is necessary for the satisfaction of creditors.

The collapse of many banks in consequence of the financial crisis after 1929 brought about a fundamental alteration of the law. It became obvious that the principle of twofold liability is not in itself sufficient for the security of depositors. During the

seventy years from 1863 to 1934, in the case of the 1219 National Banks which came under receivership and were liquidated, only 50 per cent. of the assessment and 29 per cent. of the share capital involved could be collected from the shareholders. Other methods, therefore, were sought, and a remedy was found in the insurance of deposits with a Federal agency: the Federal Insurance Corporation.

Parallel with the establishment of this Corporation and the obligatory insurance of deposits it was enacted in 1933 that for the future National banks might dispense with twofold liability, and in 1935 it was enacted that from 1 July 1937 the liability of the shareholders of National banks would cease on their giving six months' previous notice. It may be assumed therefore that within a short time the twofold liability of shareholders in National banks will become a thing of the past, and although under most, if not all, U.S.A. corporation laws the incorporators may by the articles fix the liability of shareholders as they think fit, most corporations nowadays are in practice formed with limited liability.

36. Business Corporations and Co-operatives

The term "business corporation" has an economic rather than a legal connotation. It means a corporate entity with a fixed capital divided into shares, engaged in some enterprise or business with the purpose of earning profits and generally without liability on the part of the members beyond the amount of their contributions.

The various systems of legislation, however, do not follow these lines strictly in the framing of their company laws. In the Anglo-American systems there is no special legislation regulating corporate entities which are not directed to business purposes, and even in countries whose codes have laws governing associations—in other words member-corporations (*Vereinsrecht*) it is still possible to incorporate companies not directed to carrying on a business or earning profits. Thus the revised Swiss Law of Obligations (620, par. 3) provides that a company may be created for purposes other than economic, and under German law it has always been held that a company may have non-profit making, non-economic, and even quite idealistic objects and purposes.[1]

[1] Cf. Düringer-Hachenburg, III, 3rd ed. 287.

This rule is enacted for G.m.b.H.s in § 1 of the law on G.m.b.H.s, and similarly § 3 of the law of 1937 provides that a company is a commercial association even though its object is not the carrying on of a commercial enterprise.

Although the majority of corporations in the U.S.A., of registered companies in Great Britain and of the companies on the European Continent are in fact business corporations, there are quite a number of associations which have chosen this form of incorporation in spite of the fact that their aim is not the making of profits. In this respect a special place is occupied by co-operatives.

Co-operatives are associations formed to carry on a joint enterprise not primarily for profit, but to further directly the economic interests of their members. Thus, whereas a retail trading company aims at realising, by purchase and sale of consumer goods, the maximum profit in order to distribute it as dividend or to put it to reserve, a consumers' co-operative seeks to provide its members with goods at the lowest possible prices. The function of a co-operative credit organisation is to procure the most advantageous terms for its members as seekers of credit, and not to make the highest possible banker's profits.

The co-operative movement began in the first quarter of the 19th century. It was hailed in some quarters as a panacea against the evils of capitalism; but this dream did not come true. Nevertheless co-operatives occupy a considerable place in the economic life of to-day, especially in the field of distribution, though their part in production is small. Thus, there were in Great Britain at the end of 1947 only 46 producers' co-operative societies, mostly about 50 years old, with a membership of 14,000 and a turnover of about £3,500,000. Fifteen of these societies were engaged in manufacturing footwear, nine in clothing manufacture and twelve in printing.[1]

Although we are not concerned with the co-operative movement, which calls for special investigation along different lines, it should be mentioned that the economic aims of co-operatives call for some deviation from the typical framework of the business corporation. Thus provision has to be made for including new members who may wish to join an existing co-operative, and also for methods of leaving one, as well as for ensuring a management which secures the advantages of the co-operative to the members.

[1] *The Times*, 8 March 1948.

Producers' or marketing co-operatives will in most cases seek to ensure that the members sell their raw products to the co-operative or market them through it, and so on. The way in which these aims are secured varies under different legislative systems.

In Great Britain a co-operative may be formed either as a limited company or as a friendly society. The provisions of the Companies Act are so elastic that there is nothing to prevent adequate provisions being inserted into the articles of a limited company to secure that the purposes of a co-operative are attained. Even the co-operative with unlimited liability, which in some countries is fairly usual, may be formed under the Act. The only provision that Act contains with regard to co-operatives is that a company is not entitled to use the word "co-operative" in its name or on its stationery without the assent of the Board of Trade. For many classes of co-operatives it is possible to register under the Friendly Societies Acts.[1]

Friendly Societies have not corporate capacity, and their property is vested in their trustees (sec. 49). In some respects, however, they are regulated like companies and in the matters of government control and publicity the legal guarantees are quite satisfactory. Industrial and provident societies may be incorporated under the Industrial and Provident Societies Acts.[2] The liability of their members is limited to the par value of the shares subscribed, and a member's interest should not exceed £200.

Building societies are co-operatives from an economic point of view, but in Britain they are regulated by special enactments.[3] The liability of their members is limited. Both industrial and provident societies and building societies have corporate capacity, and their structure is similar to that of companies incorporated under the Companies Act.

In the U.S.A. co-operatives are mainly concerned with the marketing of agricultural products. The principal legislative regulation is contained in the Co-operative Marketing Act of 1926;[4] in some respects the Capper-Volstead Act[5] and the Clayton Act[6] also apply. Several of the States have enacted

[1] 59 & 60 Vic., c. 25 (1896), as amended by 61 & 62 Vic., c. 15 (1898), 8 Edw. VII, c. 32 (1908), and 14 & 15 Geo. V, c. 11 (1928).

[2] 56 & 57 Vic., c. 39 (1893), as amended by 57 Vic., c. 8 (1894), 58 & 59 Vic., c. 30 (1895), and 3 & 4 Geo. V, c. 31 (1913).

[3] 37 & 38 Vic., c. 42 (1874), 57 & 58 Vic., c. 47 (1894), and 2 & 3 Geo. VI, c. 55.

[4] 7 U.S.C.A., 451–7. [5] 7 U.S.C.A., 291–2. [6] 15 U.S.C.A., 17.

regulations authorising the creation of co-operatives, and regulating their formation, operations, activities, and marketing agreements.[1]

The special points distinguishing marketing associations from business corporations are that membership and its transfer are generally restricted to growers or producers of the product concerned. Consequently it is provided that the share of a member who ceases to produce the material in question may be repurchased by the co-operative, and its surrender may be made obligatory. Frequently a member who leaves the co-operative has no right to an appropriate part of the reserves or surplus, and must be satisfied with the par value of his share.

The members by virtue of their membership are either obliged to sell and deliver their products to the co-operative at a fixed price, or to conclude with it an agreement for the exclusive marketing of their products. Such agreements are in the form of either an agency or a sale and purchase contract. They frequently provide for a penalty or for liquidation of damages in case of breach. It is sometimes provided by statute, and in any case is generally held by the Courts, that the co-operative may apply for an injunction and may sue for specific performance in order to secure the delivery of goods under the agreement.[2]

Although the statutes and the Courts in general favour co-operatives, the Supreme Court of the U.S.A. has held [3] that discrimination in favour of a co-operative against corporations or individuals engaged in the same public utility business is unconstitutional. On the other hand the Internal Revenue Code of 1939 exempted Farmers' Co-operative Marketing Associations from Federal income tax.[4]

In all countries of the European Continent there are special laws for co-operatives (*Sociétés à capital variable*, *Erwerbs- und Wirtschaftsgenossenschaften*, etc.). This was to a certain extent necessary in view of the rigidity of the company laws of these countries, which do not permit the extension of shareholders' liability to an amount exceeding the par value of their shares and the premium, if any. Furthermore the rules governing the capital structure of companies make it impossible for members who leave

[1] See Liberty Warehouse Co. *v.* Burley Tobacco Growers' Marketing Association, 276 U.S. 71, and Frost *v.* Corporation Commission, 278 U.S. 515.

[2] See Fletcher 8287, n. 95.

[3] Frost *v.* Corporation Commission, *supra.*

[4] 26 U.S.C.A., 101–12.

the co-operative to call for the repurchase or repayment of their shares. Consequently statutes have been enacted covering co-operatives as a special class of corporations. In all these countries the law of co-operatives is a special branch of law differing in many respects from that of companies proper.

We have not here to consider the details of these laws, since this book is concerned only with business corporations proper. But it should be stated that they nearly all grant co-operatives either total exemption from income tax or at least some diminution in its assessed amount, so as to enable them to compete successfully with business companies and individuals or partnerships in the branch of business concerned.

37. Business Trusts

The word "Trust" is used in many and various senses. Before we consider the various aspects of the business trust, which alone concerns us here, it will be useful to distinguish it from other types.

We speak of a trust when property is devised for a given purpose, e.g. to establish and maintain some institution, such as a welfare centre, school, research institute, and so on, so that the device is perpetual, and the funds are to be administered by trustees appointed in the first place by the donor or by some public authority, new trustees being appointed in the event of their death, although it may be that in certain cases a legal entity is created with a definite purpose and perpetual succession, and the name "trust" is therefore not adequate. It would be more suitable to call such institutions "foundations", as, e.g. the Rockefeller Foundation.

Such a purpose could be fulfilled by the creation of a trust proper, in the sense of the Anglo-American law, but there are difficulties in the way, especially as regards maintaining stability of administration on the death of the trustees, their resignation, or their inability to act. It is therefore more usual in Britain to create a limited company, in the U.S.A. a corporation, including in its articles special rules to secure the desired result. Under the European legal systems, which mostly do not recognise the trust, it is possible to create a foundation (*Stiftung*), i.e. a legal entity with a defined purpose and organisation. That purpose may be any lawful one, provided it is not for profit. Usually

the assent of the Government or of some designated public body is necessary. But governments—at least until the totalitarian experiments of this century—were generally liberal in giving such assent. It was therefore not necessary to create limited companies or use other indirect means for such a purpose.

Although such foundations (*Stiftungen*) endowed with corporate personality were used as a rule for idealistic purposes only, they sometimes carried on some business, such as printing or publishing, either as a sideline or as a main object of their activities. The foundations concerned then administered the trust property on business lines and for profit as an individual entrepreneur or business corporation would do, the only difference being that the net profits were used for welfare or scientific purposes. A well-known example of this kind was the Zeiss Stiftung in Germany, formed by Professor Abbe to manage the famous optical works at Jena.

From about 1890 the name "trust" was often used for certain industrial combinations, i.e. arrangements to associate several enterprises in order to secure a wide measure of control over a given branch of industry or commerce. This use of the term arose from the fact that in several cases in the U.S.A. the form of a trust proper was used for such combinations. Very soon, however, the holding company was found more expedient for this purpose. Nevertheless in judicial decisions, legal and economic textbooks, and even some Statutes, the term "trust" remained in use for combinations intended to secure a total or partial monopolistic control of certain sectors of economic life. It is nowadays recognised to be quite immaterial what form of legal framework is used to attain such an aim, and in consequence anti-trust legislation is directed at every device which can possibly be used to further monopolistic tendencies.

In some cases trust agreements, or so-called voting trusts, are used to ensure the control of voting rights.[1] But we must not overlook the fact that the legal device of the trust has been used for business purposes, and although in Britain this practice—never widespread—fell into obsolescence, it is still used in America to a certain extent. It is these trusts created for business purposes, business trusts in the strict sense, which we shall here consider.

If one or more persons hand over certain property to trustees

[1] See § 74.

on the understanding that those trustees shall use it to carry on a given business in the interest of the settlors, a business trust is formed. The property may be either real or personal, *inter alia* shares in one or several companies, a given amount of money to be used for the purposes provided for in the trust agreement, e.g. to buy goods or real property, to erect buildings, purchase machinery, etc.

The essential of American business trusts is that the title to the trust property (trust funds, trust *res*) must be vested in the trustees. If the title is vested in the cestuis qui trustent, there is then no trust, but some other legal form, usually a partnership. The affairs of the trust are managed by the trustees without any interference or control from the cestuis qui trustent. If the latter have control, there is no trust.

The business must be carried on for the benefit of the cestuis qui trustent. It has been admitted in the U.S.A., however, that a trustee may have an interest in the trust property.

Such business trusts first became usual in Massachusetts about 1850, and in consequence they are often called Massachusetts trusts.[1]

A special practice, evolved in the U.S.A., is that of dividing the trust property into fixed equal parts, very similar to the shares of corporations. Trust certificates are issued for the shares in the trust, their holder being called "shareholder". The trustees collect the dividends and pay them to the certificate holders, the cestuis qui trustent. In this way the business trust is very similar to a joint-stock company. The difference, however, is quite substantial. The shareholders in a stock corporation are, in principle, in control of the corporation. They may in some circumstances remove the directors if they are dissatisfied with the management; they can give them certain directions, at least on important matters. The trustees, on the contrary, are in full control, and within the limits fixed by the trust agreement they can manage the trust's affairs at their own full discretion. Furthermore they are not under duty to publish accounts and reports, whereas publicity is a distinctive point of corporate management.

The difference between the position of trusts and that of corporations brought about the use of the trust to organise the joint management of several corporations by putting the majority of the shares into a trust in such a way that the legal title to them

[1] See Attorney-General *v.* Federal Street Meeting House, 1 Black U.S. 262.

was vested in the trustees, who were consequently in a position to manage the corporations by making use of any voting rights of the majorities which they held as trust property as they might see fit, to the exclusion of the shareholders. These latter in place of their shares received trust certificates entitling them to dividends but depriving them of any voting rights in the corporations combined in the trust.

This was the most developed form of business trust. Its most notorious example, the Standard Oil Trust, formed in 1882, was dissolved in 1889. The Standard Oil Company of New Jersey, formed after the dissolution, was not a business trust but a holding company.

The trust certificates of such trusts are dealt in on the market and even quoted on the Stock Exchanges.

The original reasons for the adoption of the trust form were the prohibitions imposed upon certain classes of business, e.g. real estate business, and more generally the increasing statutory regulation of corporations. It was thought, and not without reason, that by their creation the advantages of corporations might be obtained with freedom from regulation and without involving personal liability on the part of the cestuis qui trustent. The greater ease of adapting trust agreements to the special circumstances and needs of each case was looked upon as a further advantage. The full control on the part of the trustees and the consequent greater flexibility of management were also important factors. Lastly, for a long time trusts were in a more favourable position with regard to taxation.

In course of time, however, the popularity of business trusts waned, and the gradual victory of *laisser-faire* in corporate matters made incorporation so much easier that the need for them became less urgent. At the same time State legislatures and finally Congress subjected business trusts to the same taxes as corporations. It may therefore be expected that in time the role of the business trust will be diminished and probably even extinguished.

In order to form a business trust there must be a trust agreement, sometimes known as a trust deed or settlement, defining the purposes of the trust, the capital, its division into shares, nominating the trustees and providing for the filling up of vacancies.

In some States such trusts are regulated by special statutes;

in others they are covered by the general law of trusts. A few States, among them Texas, Wisconsin and Kansas, reject them altogether and provide that they are to be regarded as partnerships or unincorporated joint-stock companies. In the large number of States which regulate them by special statutes, and in most of those which include them under common law trusts, what matters is where the power of control is vested. If it is in the trustees, there is a trust; if it is in the cestuis qui trustent it is a partnership, whatever name is used.[1] In theory the distinction is very simple; in practice, however, it is often difficult, and all the details and provisions contained in the agreement have to be taken into account in order to decide the character of the association, especially as trust agreements mostly tend to show similarities with corporations. Thus is it not unusual to provide for general meetings of the cestuis qui trustent, who are called shareholders; there is also some degree of publicity, the so-called shareholders have some right of supervision, and occasionally even a deciding power in extraordinary matters.

The Courts, both State and Federal, are inclined to overlook these extensions of powers if they do not vest the full power of control in the cestuis qui trustent. The Supreme Court of the U.S.A. has said:[2] "The Court should be solicitous to gather the object and purposes of the parties from the language of their contract rather than from the formulas applied in other cases. Such formulas must not mislead us into the belief that the essential thing to be determined is the question of management. It should not be solicitous to give corporate advantages without incorporation." [3] Under the influence of the Federal Inland Revenue Act, which made the business trust to a large extent liable to corporation income tax, the recent trend of the Court is to deny the character of trusts if they seem to be unincorporated joint-stock companies in disguise.[4]

As said above, business trusts may be and in fact have been organised for various purposes. Originally they were mainly formed to hold, manage and deal in real estate.[5] Trusts have been created to carry on the business of a firm after the death of a

[1] See Hecht *v.* Malley, 265 U.S. 144.
[2] Eliot *v.* Freeman, 220 U.S. 178.
[3] See also Crocker *v.* Malley, 249 U.S. 223.
[4] See the Helvering cases, 296 U.S. 365.
[5] See the Federal Street Meeting House case, *ante*. For trusts for the construction, management and control of apartment houses see Swanson *v.* Commissioner of Internal Revenue, 296 U.S. 362.

partner,[1] or to hold patent rights. They have frequently been organised for the purchase and sale of oil and gas royalties and for the purpose of drilling for oil.[2] Trusts have also been founded in case of insolvencies to carry on the business in the interest of the owner and the creditors.[3] In general, in so far as their creation is not forbidden or restricted by legislation, they may be formed for any lawful object.[4] In several States, however, it is provided that banking, insurance, building and loan businesses cannot be carried on by trusts.[5]

In so far as business trusts are not prohibited they are valid and legal organisations. But it is generally held that, although valid in principle,[6] they may be invalid if created in order to evade some legal prohibition or to deprive third parties of their rights. Thus a trust created with the aim of injuring creditors and depriving them of the means to satisfy themselves out of the assets of the debtor is inoperative as against creditors. Whether a trust actually has such illegal purposes is a question of fact and may be controversial. In this regard the so-called anti-trust legislation, directed against industrial combinations in whatever form, is of importance; with it, however, we are not concerned.

A trust may be created by any person with capacity to hold property and to contract. It is therefore to be assumed that not natural persons alone but corporations also may create trusts, although it has been held that a railroad company has no power to create a real estate trust for property no longer available for railroad purposes and which the corporation was under the duty to sell.[7] Even if this rule were to be extended to other cases, it is undoubted that corporations may act as trustees of business trusts.

It is fairly usual to adopt a collective name for a trust. The name is to be fixed in the trust agreement and is frequently a fictitious one. Some States forbid the use of names which would imply the existence of a corporation, but in fact the names used for trusts are often similar to those of corporations. Some States, e.g. Florida and Wisconsin, require the trust agreement to be registered or recorded with a specified public office.

[1] Burwell *v.* Cawood, 2 How. U.S. 560, and Smith *v.* Ayer, 101 U.S. 320.
[2] Helvering *v.* Combs, 296 U.S. 365.
[3] See Fletcher 8231, n. 60–63.
[4] See Morrisey *v.* Commissioner of Inland Revenue, 296 U.S. 344.
[5] See Noble State Bank *v.* Haskell, 219 U.S. 104.
[6] Claggett *v.* Kilbourne, 1 Black 346.
[7] See Williams *v.* Johnson, 208 Mass 544, quoted by Fletcher 8234, n. 92.

On the creation of business trusts it is usual to provide for subscription. The position of subscribers is similar to that of subscribers of shares in corporations. Particularly, they may attack their subscription for fraud, rescind it, and *per accidens* sue for damages and recovery of the amounts paid.[1]

The property of the trust held by the trustees is the joint property of the cestuis qui trustent, though they have no title to it individually; they can neither convey nor encumber such property,[2] and are merely its equitable owners in proportion to their participation, i.e. to their shares. They are entitled to participate in distributions and in the net remainder at the winding up, after debts have been paid.

Trust agreements mostly provide for trust certificates to be transferable, and for the death of the holder not to affect the existence of the trust. Trust certificates are merely evidence of participation, and do not represent the shares themselves any more than do share certificates in corporations. Participation in the trust, and consequently the trust certificate, is personal property even if the trust property is mainly or exclusively real. But it has been held that where the trust property was exclusively real property and the trust agreement did not require the conversion until it was sold, the doctrine of equitable conversion would not apply.[3]

Business trusts usually have books and records of transfers, and it is often provided that transfers of shares shall not be effective as against the trust unless reported to the trustees and recorded in the books. Such regulations and restrictions of transfer, if provided for by the original trust agreements, are valid, whereas subsequent alterations or restrictions are held not to be operative without the assent of the shareholder concerned.

There is an inclination to provide for meetings of the certificate holders in a way similar to general meetings of corporation shareholders. This tendency appears in provisions concerning the convoking and proceedings of the meeting, especially as to voting and quorums. Sometimes the filling of vacancies on the board of trustees is reserved to such meetings and even the power to remove trustees in proper cases is conferred on them. But the borderline between corporations and trusts is very fluid, and the extension of shareholders' rights may lead to the trusts being

[1] See Fletcher 8239.
[2] See Brown *v.* Gilman, 4 Wheat. U.S. 255.
[3] Fletcher 8242, n. 56.

treated as a partnership or an unincorporated joint-stock company. The position of trustees is identical with that of trustees in common law trusts. It is generally held that corporations may be appointed as trustees.

Although trustees are persons in whom the property and the power to control and to dispose is vested for the interest and benefit of the cestuis qui trustent,[1] in the case of business trusts it has been recognised that the trustee may have a beneficial interest in the trust, especially if there are several trustees and not all of them hold a beneficial interest as shareholders.[2] But where there is only one trustee and he is at the same time sole beneficiary, the legal and equitable titles are merged; in other words no valid trust exists.[3]

Trustees of business trusts are entitled to the reimbursement of their expenses and to reasonable compensation for their work. This is in most cases expressly regulated by the trust agreement, but it is held that they may claim reimbursement and reasonable compensation even without this. The agreement may authorise the trustees to fix their own compensation, and it has been held[4] that such compensation should not exceed a certain percentage of the income; further that the agreement is valid if the compensation is based upon gross income, provided it does not exceed a certain fixed percentage.

Apart from cases provided for in the agreement, trustees may be removed by a Court of Equity for proper cause, even in the absence of any provision for removal in the agreement. The Court may appoint new trustees and replace those removed.

Trustees must exercise their office with such diligence as a prudent owner would deem necessary. The agreement may contain provisions relating to the exercise of their powers, and also limiting or extending their liability. No trust agreement may validly exclude the liability of trustees for breach of trust.

Trustees may apply to the Court for instructions and directions as to the administration of trust property in the same way as trustees in common law trusts.

In general the unanimous resolution or assent of the trustees is required to validate a contract; but the trust agreement may provide otherwise. Usually a majority is required, and in the

[1] Taylor *v.* Davis, 110 U.S. 330.
[2] See Fletcher 8246, n. 22.
[3] See Fletcher 8246, n. 43.
[4] Swanson *v.* Commissioner of Internal Revenue, 296 U.S. 362.

case of merely ministerial acts and such as do not require the exercise of discretion, unanimous or majority consent, as the case may be, is not required.[1]

Trustees, under the general rules, are not entitled to delegate their powers, but they may be authorised by the trust agreement to do so. The delegation frequently takes the form of appointing a co-trustee. The appointment of employees for the administration of the business is to be distinguished from the delegation of powers. The trust agreement usually contains provisions for such appointment. Whether in their absence an appointment may be valid is disputed; but it is universally accepted that if the employees have merely to perform ministerial acts the appointment is valid even if unauthorised by the trust agreement.

The general view is that a trustee is not responsible for the misconduct of his fellow trustees, where he neither assented to the misconduct nor made it possible by his own neglect. A trustee is, however, under a duty to inform himself about the business and the contracts connected with it, and he cannot escape responsibility by neglecting to take due care in obtaining information and in supervising the activities of his fellow-trustees.

It is held that a trustee may restrict his liability under trust agreements which contain a provision that each trustee shall be liable only for his own acts. An agreement that a trustee shall be liable only for wilful breach of trust has also been held valid.[2] Both these rules are exceptions which cannot be recommended, for reasons given in connection with the position of trustees for debentures (see § 60, Vol. II).

The acts done, and especially the contracts made by trustees are binding upon the trustees themselves. The Supreme Court of the U.S.A.[3] said: "When a trustee contracts as such, unless he is bound no one is bound, for he has no principal. The trust estate cannot promise; the contract is therefore the personal undertaking of the trustee." This view is generally accepted,[4] and on this basis it may be stated that contracts of trustees are binding on them. It is immaterial whether they made the contract in their own name or in that of the trust.[3]

Trustees, however, may exempt themselves from personal liability by an express stipulation made with the other party. As the Supreme Court said: [3] "If a trustee contracting for the

[1] Fletcher 8251, n. 67–9.
[2] Fletcher 8253, n. 81.
[3] Taylor v. Davis, 110 U.S. 330.
[4] See Fletcher 8254, n. 82.

benefit of a trust wants to protect himself from individual liability on the contract, he must stipulate that he is not to be personally responsible but that the other party is to look solely to the trust estate." A provision in the agreement to the effect that the trustees shall not be liable for contracts made by them *qua* trustees is inoperative as against the other party, even if he has notice of this provision at the time of making the contract. This rule was weakened by some decisions holding that if the trustees sign the contract in such a way as to specify clearly that they are acting merely on behalf of the trust and not as individuals, they are exempt from personal liability.[1]

Even in cases where trustees are liable for contracts made in benefit of the trust, i.e. where they have not exempted themselves from personal liability, the creditors may look for their satisfaction also to the trust funds. They may sue in equity, and, in States which establish the liability of the trust estate for contracts made for the benefit of the trust, may bring statutory action. Some States have adopted the doctrine that creditors may reach the trust estate only when the trustees are entitled to be indemnified from liability as against the trust. It is held, e.g. in Massachusetts, that a creditor may demand satisfaction from the trust estate only if the position between the trustee and the trust shows that the former is entitled to indemnity or reimbursement out of the trust estate. As a rule creditors have no lien on the trust estate. The trust agreement may also provide that creditors shall seek their satisfaction primarily from the trust estate.

The liability of trustees for their torts is governed by the general rules, in virtue of which they have no right of recovery from the trust estate. But it has been held that the trust agreement may provide otherwise, and that trustees may be exempted from liability for their torts as against the trust.[2]

Shareholders in trusts are under no obligation or liability as against third parties, and there is no necessity to stipulate for such exemption in the trust agreement. In practice most trust agreements contain provisions exempting holders of trust certificates as beneficiaries from personal liability.[3] They may be liable for some special reason, e.g. where they have taken part in the contract. If the association cannot be regarded as a trust and is in fact a partnership, the holders of trust certificates are of

[1] See the cases, Fletcher 8254, n. 89.
[2] See Fletcher 8255, n. 98–9.
[3] See Hamphill *v.* Orloff, 277 U.S. 537.

course liable; in many cases the fact that control is vested in the shareholders will justify the view that there is in fact a partnership and not a trust. In such a case it is not possible by the trust agreement to exempt the shareholders from personal liability.[1]

Under some State legislations, as we have seen, trust agreements are regarded as creating a partnership, or—as in Kansas—the shareholders of a business trust are individually liable in the same way as organisers of a corporation whose organisation has not been completed. In Texas the statute has been construed in the sense that business trusts are general partnerships. But even under these systems it is possible to exclude liability by express stipulation with the individual creditor. It is to be remembered that the trustees are in a fiduciary relation to the shareholders as their cestuis qui trustent, and their relation is held to be of a more confidential character than that existing between directors and shareholders.

Trustees are bound to exercise reasonable skill, prudence and judgment in performance of their duties as to management, and are liable to the shareholders for losses arising from neglect. As already mentioned, the tendency is to insert in the trust agreements clauses restricting liability as against shareholders. Frequently the agreement indemnifies trustees against honest errors of judgment. Such a clause may be justified, but some agreements restrict liability in cases of wilful breach of trust or of wilful default or neglect. The validity of such clauses is doubtful, and in any case they are not to be recommended.

If the trustee has adverse interests he is disabled from voting in favour of or concluding a contract. He cannot personally acquire property which he ought to acquire for the trust, and if he does so he is held to be under duty to hold it for the interest and benefit of the trust. But trustees are held not to be excluded from taking part in the trust as shareholders, and they may purchase shares from shareholders. That the validity of such purchase is held to be dependent upon the trustee's good faith and fairness is of little help.

In so far as the trustee has acted in good faith and for the benefit of the trust he is entitled to indemnity in respect of obligations incurred in performing his duties. Attached to this indemnity is reimbursement, and for expenses incurred by him

[1] See Fletcher 8261, n. 95–8.

in administering the trust property he has a lien on the estate in his hands.[1]

The trustees are the persons to sue and be sued on behalf of the trust. Except in cases where shareholders are personally liable for debts they cannot be sued.

The shareholders may intervene in lawsuits instituted against trustees under the general rules governing interventions.

The duration and termination of a trust is governed by the trust agreement. The rule against perpetuities applies to trusts and especially to business trusts,[2] but in some States business trusts are exempted from the rule against perpetuities, especially where the trust estate may be conveyed at any time.[3] Similarly, a trust the subject of which is personal property has been held not to be covered by the rule against perpetuities if it is terminable at any time.[4]

The statute of uses is not applied to trust estates even though the shareholders have power to remove the trustees and to fill vacancies, and in Michigan business trusts are expressly exempt from the statute.[5]

Several States have enacted statutory rules expressly recognising business trusts and regulating their formation and activities. The most important of these enactments is the Massachusetts Law of 1933 (ch. 182, secs. 1–11). Some of these statutes adopt for business trusts rules somewhat similar to those applying to corporations. Other States have prohibited the formation of business trusts or have provided that they are to be regarded as partnerships or unincorporated joint-stock companies. If such discrimination can be regarded as reasonable it is not against the equal protection clause of the Constitution. But if the business trust is differentiated from other unincorporated associations, the discrimination may be objected to under that clause.[6]

When trust certificates or trust bonds are issued in the market they are generally subject to "blue sky" legislation and regulation, and the constitutionality of such application of these laws has been upheld.

As we said earlier, business trusts were not originally taxed as corporations under the various Federal Income Tax Acts, especially those of 1913–16.[7] The special excise tax imposed

[1] See Fletcher 8258, n. 28. [2] See Eliot *v.* Freeman, 220 U.S. 178.
[3] Fletcher 8268, n. 73. [4] Fletcher 8268, n. 74–6. [5] Mich. Rev. St. 1846, ch. 63.
[6] See Fletcher 8271 and Brady *v.* Mattern, 125 Iowa 158, quoted by Fletcher 8271, n. 94–6. [7] See Eliot *v.* Freeman, *supra*; Crocker *v.* Malley, 249 U.S. 223.

upon corporations by the Act of 1918 has, however, been held to extend to business trusts, since this Act provides that the term "Corporation" should include associations.[1] The Internal Revenue Code of 1939 provides that the term "Corporation" should include associations, joint-stock companies and insurance companies.[2] Under this Act it has repeatedly been held that where trustees are conducting a business enterprise for profit for the benefit of a trust, the trust is taxable as a corporation.[3]

If we take into account that nowadays the formation of corporations is regulated only in so far as necessary to safeguard the interests of the shareholders, the actual and prospective creditors and the public, there is no reason to concede that the trust device should be used for carrying on business on a permanent basis. Consequently the view taken by certain U.S. State Legislations which prohibit business trusts altogether, or deal with them on the same footing as partnerships or unincorporated companies, seems justified. The difficulty arises in drawing the line between trusts based on wills or settlements, and trusts aimed at carrying on business for an indefinite time.

The trust device has had a further application in connection with business corporations. Shares have been transferred to trustees for permanent holding with instructions to apply the dividends for certain purposes. Although shares, especially ordinary shares, are not as a rule eligible as trust investments, and trustees will not be held authorised to invest trust funds in such shares, there is nothing to prevent a settlor from devising such securities for a certain purpose and conveying them to trustees. It is held by English law that any property, whether real or personal, may be made the subject of a trust.[4] The same is held in the U.S.A., and though trustees generally are under the obligation to sell the original investments when their retention would be imprudent, a specific authorisation to retain the securities in which the trust funds were originally invested is neither invalid nor contrary to public policy.[5] The settlor may even give definite instructions to the trustees not to part with the original investments.

[1] Hecht *v.* Malley, 265 U.S. 144; Burk-Waggoner Oil Association *v.* Hopkins, 269 U.S. 110.

[2] 26 U.S.C.A., sec. 3797.

[3] See the Helvering, Morrisey and Swanson cases, *ante*; Twin Bell Oil Synd. *v.* Helvering, 293 U.S. 312, and many other cases.

[4] Lewin, *On Trusts*, p. 36; Halsbury, 33. n. 192, p. 110.

[5] Cf. A. W. Scott, H.L.R. 57, pp. 608 and 613.

This possibility seems harmless in respect of trusts in connection with family settlements or wills in favour of the next of kin. It may be otherwise if the trust is intended to be permanent, and the trust funds include shares which give majority or effective minority control over a company. In such a case the way would be open for securing perpetual control over the enterprise concerned. This seems a far-fetched possibility, but is none the less a real one. Thus in two corporations of the Rockefeller group trusts hold large blocks of common stock with voting rights. In Standard Oil of New Jersey (end of 1937), 4·82 per cent. of the voting rights were exercised by three trusts which were under the control of the Rockefeller family. At the same time the Rockefeller Foundation held 4·53 per cent. in the Standard Oil Company of Indiana, whereas 1·41 per cent. was held by trustees for the employees' welfare and stock purchase plan. In the former company the trusts were the second largest, in the latter the largest shareholders. In view of the wide dispersal of ownership in the stocks of large corporations, stockholdings exceeding 5 per cent. may be able to play an important, even in some cases a decisive role. A similar position is reported of the Morris Motors concern in Britain, in which the trusts created by Lord Nuffield are said to hold large blocks of stock.

The present trend of taxation, which leads to the increasing absorption of income from dividends by income tax and surtax, makes the transfer of stock to trusts very attractive, if only the exercise of voting rights and the control of the enterprise with all the direct and indirect advantages connected therewith can be secured for the settlor and his successors.

This is merely a question of draughtsmanship. Consequently, so long as such high standards of taxation prevail, the possibility of the creation of similar trusts is not to be excluded. This might lead to the permanent domination of enterprises by trustees with little if any material interest in the company. We feel that such possibilities should be countered now, while we are still at the beginning of this evolution.

38. Corporate Name

The name of a corporation is the visible sign of its existence as an entity independent of its members; every corporation therefore must have a special name. This has been recognised

from the earliest times. Bacon (*Abridgement* 44) said: "The names of corporations are given of necessity, for the name is as it were the very being of the constitution, for though it is the will of the King that creates them yet the name is the knot of their combination, without which they could not perform their corporate acts, for it is nobody to plead and, being pleaded, to take and give until it hath gotten a name." Similarly, we find in Rolle's abridgement: "Corporation: The name of incorporation is the proper name or a name of baptism." Blackstone [1] summarised the state of the law in these words: "When a corporation is enacted a name must be given to it, and by that name alone it must sue and be sued and do all legal acts, though a very minute variation therein is not material. Such a name is the very being of its constitution and though it is the will of the King that erects the corporation yet the name is the knot of its combination without which it could not perform its corporate functions."

It has therefore always been held that the charter which brings a corporation into existence must give it a name, and since corporations have been allowed to be formed freely under deeds of settlement and later under a memorandum of association the rule has been that a corporation must adopt a name in its constituent act, and that name is a part of its constitution, its alteration being subject to special rules.

Under most legislations a company may not have more than one name. This was the view of the Common Law, and it is strictly adhered to under the Companies Act. Under German law it is held by the overwhelming majority that a company may not have two or more names (firms) even if it carries on two or more separate and different businesses.[2] The same rule is followed in Switzerland, where it is expressly provided that even branches with a certain degree of independence (so-called *Zweigniederlassungen*) must have the same name as the head office, save that they may attach thereto words whose sole purpose is to distinguish the branch. The same was held in Germany,[3] whereas earlier words stating it to be a branch were alone held admissible. In the U.S.A., however, the question is disputed, and in most States a corporation may have several names for different purposes.[4]

[1] *Commentaries*, vol. I, 474–5.
[2] Duringer-Hachenburg, s. 82, n. 40; Staub, s. 182, n. 16.
[3] R.G.Z. 113, 213, 114, 320. [4] Cf. C.J. 14, s. 337, and Ballantine, s. 17.

It is generally accepted that the name must contain a statement as to the character of the corporation.

Under the Companies Act (sec. 2 (1) (*a*)) the name of a company limited by shares or guarantee must include as its last word the word "limited", unless it be a non-profit-making company and the payment of dividends is prohibited. In such a case the Board of Trade may by licence permit the omission of the word (sec. 19). On the other hand the use of the word "limited" by individuals or partnerships, and generally where no corporation exists, is prohibited (sec. 439). These rules of course apply only to registered, and not to chartered and statutory companies, whose names are bestowed by the charter or Act of Parliament respectively.

In the U.S.A. most statutes similarly require the inclusion of the word "corporation" or "incorporated" or the abbreviation "inc." in the name of the corporation.

In France, where stringent provisions as to the names of companies are in force, it is nevertheless not required that the company's character as a *Société Anonyme* should be stated in its name.

In Switzerland the definition of the company as an *Aktiengesellschaft* is required only where its name includes the names of individuals, e.g. Nestlé, and if the word precedes the names of persons it must not be abbreviated (sec. 950).

Under German and many other Continental legislations the requirement resembles that of the Anglo-American systems: the name of the company must contain the word *Aktiengesellschaft*. Even if a company acquires a going concern with the right to use the commercial name hitherto existing (called firm, *Firma*) the word *Aktiengesellschaft* is to be inserted in the name of the company under § 4 (2) of the Companies Law of 1937.

The *Code de Commerce* prescribed that the name of a *société anonyme* should be taken from the subject of its enterprise (art. 30), and this rule is still maintained. It was adopted outright by a number of Continental legislations and even by the German law, which, although it allows of the use of the names of individuals, or even of fancy names, always of course with the addition of the word *Aktiengesellschaft*, nevertheless prescribes as a general rule that the name of a company shall be taken from the subject of the enterprise.[1] This means that if a company adopts a fancy

[1] § 4 (1), Companies Law of 1937.

name, some words referring to the subject of the enterprise must also be included, e.g. "Hibernia Coal Mining Company" or "Phoenix Company for Mining" (*Phoenix Bergbau Aktiengesellschaft*). This requirement, however, applies only to new undertakings; if a company acquires an already existing concern with the stipulated right to use its name, it is not necessary to include words referring to the subject of the enterprise, though the word *Aktiengesellschaft* is to be added.

Anglo-American law lays down no restrictions in this matter. Incorporators may choose any name they think fit, including fancy names.

The leading principle regulating freedom in this respect should be that the company's name may not contain words which might mislead the public or involve injury to third persons. This is not completely effected by the existing legislation. Thus the Companies Act (1929) contained a number of restrictive provisions directed at achieving both these aims, but they are far from complete, as will be shown when we examine the proposals of the Cohen Committee.

The statutes of the American States contain various clauses on this point. The main provisions of the New York law are as follows. The use of the words "trust", "banker", "banking", "acceptance", "guaranty", "finance", etc., is restricted to moneyed corporations and membership corporations organised exclusively for the promotion of the interests of savings banks and life assurance. Similarly the use of the word "co-operative" is prohibited if the corporation is not organised under the special law regulating co-operatives.[1] The words "United States", "National", "Federal", "State" may not be included in the name unless it is a public corporation. The use of a name identical with that of an existing corporation authorised to do business under the laws of the State or so nearly resembling it as to be calculated to deceive is prohibited. Lastly, a corporation formed by the reincorporation, reorganisation or consolidation of other corporations may not have the same name as the corporation or one of the corporations to whose franchises it has succeeded; this rule applies also where a corporation has acquired the property or franchises of one or several corporations.[2]

Under German law no name or affix may be used which

[1] L. 1926, c. 231.

[2] Gen. Corp. Law, s. 9, as amended by L. 1942, c. 470. Cf. Ballantine, ss. 115–7.

might mislead the public as to the kind or volume of the business,[1] and the practice of the Courts was fairly strict, especially in preventing the use of high-sounding names by insignificant concerns.[2]

As to identity with and similarity to existing names, German law looks only at concerns carrying on business in the same place or community, but it protects not only pre-existing companies but also every one-man firm or partnership which was registered previous to the formation of the company concerned.[3] Companies, partnerships or one-man firms carrying on business outside the same place or community may protect their interests under the provisions of the law against unfair competition. The extension of the protection to cover one-man firms and partnerships is a consequence of the German idea regarding commercial names (firms) which requires registration even if the name under which a business is carried on is identical with the surname and Christian name of the merchant or those of all the partners. The local restriction is mainly due to the decentralisation of registration (cf. § 40).

The principle of the German law is accepted by most Continental legislations. The Swiss Company Law, however, provides that the names of companies, G.m.b.H.s and corporations must differ from that of any firm registered at any place within Switzerland (951, par. 2).

The British Companies Act of 1929 (sec. 17) prohibited the use of certain names, or makes it dependent on the assent of the Board of Trade. Thus no company whose name contains the words "Chamber of Commerce" might be registered unless it be one which is to be registered under licence of the Board of Trade without the addition of the word "limited", and no company may call itself a "Building Society" (sec. 17 (1)). Further, the consent of the Board of Trade is required for the registration of a name containing the words "Royal", "Imperial" or any other word which in the opinion of the Registrar is calculated to suggest the patronage of His Majesty or of any member of the Royal Family or connection with H.M. Government or any department thereof, or of one which contains the word "Municipal" or "Chartered", or in the opinion of the Registrar suggests connection with any municipality or other local authority, or with

[1] § 18, par. 2 of the Rev. Comm. Code of 1897.
[2] § 18, n. 12 (*b*) and (*c*).
[3] § 30 of Rev. Comm. Code.

any society or body incorporated by royal charter. Similarly, the Board's consent is required for the use of the word "co-operative" (sec. 17 (2)). The use of high-sounding words not appropriate to the kind, class or volume of the business is not, however, expressly prohibited by the Act, and consequently there have been cases in which companies with small resources have been registered under quite inappropriate names. Before the Cohen Committee it was specially stressed that names including the words "corporation" or "trust", which in Great Britain are generally understood to refer to large units, had been registered for companies with quite insignificant resources, and also that the word "bank" was used by companies with neither the intention nor the means to carry on a banking business proper.

Under the Act the Registrar had no power to refuse registration on the ground that the name chosen is calculated to give rise to erroneous assumptions as to the class or standing of the enterprise, its resources and probable volume of business.

Substantial protection is given to companies already existing at the time of the registration. Sec. 17 (1) (*a*) provides that no company shall be registered under a name which is either identical with that of a company already registered or so closely resembles it as to be calculated to deceive. But this does not apply if the earlier company is in process of being dissolved and also gives its consent in a manner required by the Registrar.

In case of resemblance everything depends on whether the new name is apt to deceive, i.e. to create the impression in prospective customers that they are dealing with the same company. On this point the place and nature of the business will be decisive. Should the Registrar conclude that there is identity or close resemblance which might create a false impression as to identity, he will refuse registration, and in that event *mandamus* will probably not lie.[1]

If the earlier company becomes aware of the intended registration, it may apply for an injunction to restrain the incorporators, and thereby prevent registration. It will then be for the Court to decide whether there is identity or close resemblance. Even if the company has already been registered, interested parties will not be prevented from bringing action (the so-called passing-off action), and if they succeed the new company will have to change its name.

[1] Cf. R. *v.* Registrar of Companies (1912), 3 K.B. 23.

The Registrar's power to refuse registration on the ground of identity or close resemblance is restricted to clashes of name with earlier registered companies. But conflicts may arise in some cases with the names of chartered and statutory companies, and much more with those of friendly societies, or with business names of one-man firms and partnerships or their trade marks. Should the Registrar find that the adoption of a name by a company in formation would lead to such a conflict, he may try to dissuade the applicants from adopting the name in question, but if they refuse he has no power to reject. He has, however, no means of ascertaining the existence or non-existence of previous similar names, except in the case of friendly societies. The case of one-man firms and partnerships is specially difficult. It must be borne in mind that the registration of a business name in Great Britain is provided for only where the business name used is not identical with the surname of the owner, or with those of all the partners, or contains an addition other than an indication that the business is carried on in succession to a former owner of the business.[1] Furthermore the number of registered business names exceeds 300,000, and to make a thorough search before registration would be a huge task.

Although the protection given by the Companies Act is thus restricted to previously registered companies, the Courts actually give a remedy in cases where the use of the name would give the impression that the company is carrying on the business which is carried on by another, regardless whether the latter be a company, an individual or a partnership.[2] The injured person may sue for an injunction to prevent the further use of the words creating the impression complained of and may claim damages in a proper case.

The basis of this protection is not the exclusive right to use the name: the Courts do not accept the doctrine that previous registration or use gives property in the name,[3] but the danger of deception or confusion. Where this is not likely to arise there is no jurisdiction.[4] Even if the name of a company should include a name to the use of which it would otherwise be entitled, the

[1] 6 & 7 Geo. V, c. 58.

[2] Lee *v.* Haley (1869), L.R. 5 Ch. App. 155; Reddaway *v.* Barnham (1896), A.C. 199.

[3] Du Boulay *v.* Du Boulay (1869), 2 L.R.C.P. 430; Hendriks *v.* Montagu (1887), 17 C.D. 638.

[4] Cf. *inter alia* Randall Ltd. *v.* British Shoe Co. (1902), 2 Ch. 354.

fact that the public may be led to the erroneous belief that it has to do with another earlier established firm is ground for remedy, that is, injunction before registration and passing off if registered.[1]

Originally the name of a company was considered so essential that it could not be changed except by a new charter or Act of Parliament. Even under the Companies Act the name can be changed only by special resolution and approval of the Board of Trade (sec. 19 (1)). This does not apply in a case where the change is to be made in consequence of identity or close resemblance; the Registrar's sanction is then sufficient (sec. 19 (2)).

It is superfluous to state that a change of name in no way affects the legal position of a company. In earlier times this was disputed in some cases, but nowadays under all the legislations there is no doubt on this question.[2]

The Cohen Committee did not suggest any extension of the provisions of the Act or the creation of new categories of prohibited names. It proposed instead to give the Registrar power to refuse registration should he consider that the proposed name was "calculated to mislead". Against his decision there would be an appeal to the Board of Trade, but not to the Court. Furthermore the Committee was opposed to any measure which would restrict this power or would impose any obligation to state in Regulations the precise circumstances in which names would be rejected (sec. 16, p. 11). The reasons given are twofold. The first is that in the Committee's view a refusal to register a proposed name would not deprive anyone of an existing right, since after all a vested interest would be created only by the registration and the Registrar—or, in case of appeal, the Board of Trade—would only be rejecting a request to create a vested interest for the future. Secondly, the Committee considered that any attempt to catalogue misleading classes of names would be futile; the list contained in the Act has not proved sufficiently comprehensive, and any similar list that was drawn up might well be found incomplete in the light of subsequent experience.

It is submitted that neither of these two arguments is convincing. Granted that no list is or can be complete, this does not justify the omission of any direction to the Registrar and the

[1] Madame Tussaud & Sons *v.* Tussaud (1890), 44 C.D. 678; Manchester Brewery *v.* North Cheshire and Manchester Brewery Ltd. (1899), A.C. 83.

[2] Ballantine, s. 17, Corpus Juris 14, 321.

Board of Trade, which would at the same time give valuable information to the general public. On the other hand, in view of the difficulty of finding a suitable name for an undertaking, it is hardly possible to say that those who wish to incorporate a company have no lawful interest in the name which they may choose. All the preparatory work and expenditure involved might be wasted in consequence of the attitude of the officials who make the Registrar's or the Board of Trade's decision, and there would be no remedy. Much harm might be done if the Registrar or the Board were to adopt too narrow a view as to the names proposed for newly formed companies. The parties therefore should not be deprived of the possibility of appeal to the Court, which would undoubtedly take all steps to secure careful examination of every aspect of the conflicting interests.

Lastly, it is to be deplored that the Committee did not accept a suggestion by the Registrar of Companies that incorporators should be empowered to earmark a certain name for a company to be incorporated. In view of the difficulties of providing a suitable name such a possibility would be welcome, and if restricted to a short period and made dependent on the payment of an adequate fee, no legitimate interest would be impaired.

The Companies Act 1947 (sec. 78) accepted the Committee's recommendation that no company should be registered under a name which in the opinion of the Board of Trade is undesirable. This provision, now sec. 17 of the Companies Act 1948, came into force on 1 December 1948, sec. 17 of the 1929 Act thereupon ceasing to have effect. Whether the unfettered power given to the board will prove satisfactory in practice, only experience will show.

39. Autonomy of Corporations: Memorandum and Articles

Under the system of individual charters each charter contained a more or less elaborate regulation of the corporation in question. But even so many matters were left to be dealt with by the corporation itself. In some cases the charter expressly empowered the corporation to enact rules on matters not covered by the charter. These rules were usually called by-laws.

The necessity for such by-laws is obvious. No charter, especially in view of the little experience then available, could

provide solutions in the form of rules to be applied in the undefined and indefinable number of identical cases, in Blackstone's words (vol. I, 475) "for the better government of the corporation".

The importance of these by-laws was clearly recognised, and the view prevailed that, as Blackstone put it, by-laws are "necessarily and unseverably incident" to every corporation. It was therefore held that a corporation is empowered to make by-laws even if this power is not expressly conferred on it by its charter.

The by-laws of a corporation are binding on itself and its members; as Blackstone pregnantly said, they are private statutes of the corporation. It is to be borne in mind that by-laws in order to be valid must be adopted by the members, and therefore the real basis of their binding character is the members' voluntary assent to them. Further, it was recognised from the beginning that by-laws cannot be contrary to the charter, and that in so far as their provisions are not in accordance with it they are void.

With the introduction of general corporation laws the position was altered, in that every corporation had to fix in its constituent act (see § 41) at least the essentials of its future government.

In England the Act of 1844 required a Deed of Settlement, the Act of 1856 a Memorandum of Association, to be drawn up and signed by at least seven members, in which certain essentials are to be laid down. Any corporation could extend the contents of its memorandum and insert further provisions. But this was seldom if ever done, since the provisions of the Memorandum were held to be unalterable. For the details of their government, especially their internal government, companies could adopt regulations called Articles of Association, instead of the term by-laws formerly used; but they were not bound to do so, since the Act itself in a schedule set out model articles with the provision that if and in so far as a company should not have drawn up articles of its own, the provisions of the schedule should apply. This legislative technique is still in force.

The Companies Act requires very little information to be included in the Memorandum of Association. The Memorandum of a company limited by shares must contain:

(*a*) The name of the company.

(*b*) Whether the registered office is to be situate in England or in Scotland.

(*c*) The objects of the company.

(*d*) A statement that the liability of the members is limited.

(*e*) The amount of share capital and its division into shares.

(*f*) The Association Clause, i.e. a declaration that the subscribers who have decided to create the company "are desirous of being formed into a company" (sec. 2 and Table B).

Table A of the First Schedule, on the other hand, contains no less than 136 sections which are to apply to any company in so far as its articles do not exclude or modify the regulations therein contained. In practice most, if not all, companies have their own articles, though Table A has done a great deal to influence and settle their customary contents.

Both Memorandum and Articles have to be filed with the Registrar, and are in consequence open to inspection by any person who desires (see § 40).

The distinction made between the Memorandum and the Articles of Association was originally very far-reaching. The founders and incorporators of the company were free to adopt any form of Memorandum they thought fit, but once adopted its contents were unalterable, except for an increase of the share capital. The Articles on the other hand could be altered, though only in a specific way by a special resolution of the shareholders in general meeting.

Gradually, however, the rule that the provisions of the Memorandum of Association are unalterable lost its force. At the present day, though a company (sec. 4) may not alter the conditions contained in its Memorandum except in those cases for which express provision is made in the Act, this has but little meaning, since there is only one such provision: the part of the United Kingdom in which the registered office of the company is situated cannot be altered, except of course by Act of Parliament. All other provisions of the Memorandum are alterable either by a special resolution, or—in case of a change of name—with the assent of the Board of Trade, and in case of an alteration of the company's objects, with the confirmation of the Court (see § 43). It is to be noted, however, that the power to alter the Memorandum and Articles of Association is vested in the shareholders in general meeting, and cannot be delegated to the board of directors.

The legislations of the British Commonwealth of Nations follow the Companies Act both in terminology and in effect, except for Canada. There the part of the Memorandum of Association is played by the Memorandum of Agreement and

the application for the issue of a charter (Letters Patent). The Act does not contain a table of articles: it prescribes instead all the matters which may be regulated by by-laws. The by-laws may be enacted, altered or repealed by the board of directors, but any such enactment, alteration or repeal is to be submitted to the next annual general meeting for confirmation, if not sanctioned earlier by a special general meeting called for that purpose. Otherwise by-laws shall have force only until the next annual general meeting, and if not confirmed thereby shall cease to have effect. This rule is not to apply to by-laws made in respect of agents, officers and servants of the company (secs. 92, 95).

In the U.S.A. a distinction is likewise maintained between the document containing the essentials and that containing the detailed regulations, as it evolved at the time of the formation of corporations by individual charters. The former is called the Articles or Certificate of Incorporation; for the latter the old term "by-laws" is still used.

The contents of the articles or certificate of incorporation are still regarded after incorporation as the charter of the corporation, and cannot be altered without the assent of the public officer with whom the articles or certificate is filed.

The minimum of matters to be settled in the articles of incorporation is prescribed by the various statutes; it includes generally more details than does the British Companies Act. Thus the New York Act requires that there be stated:

(1) The name of the corporation.
(2) The purposes for which it is formed.
(3) Particulars of the amount of the capital and its division into shares, with their par value, or, if they have no par value, the statements required for such a case.
(4) Particulars relating to the different classes of shares, if any.
(5) The location of the office of the corporation within the State and the address at which writs may be served on it.
(6) The duration of the corporation.
(7) The number of directors.
(8) Their names and addresses.[1]

The statutes of other States make more or less identical provision.

In earlier times the charter provisions were regarded as

[1] Stock Corp. Law, s. 5, as amended in 1934 in Second Extra Session by Law of that year, c. 908, s. 1.

unalterable in the same way as in Great Britain. Nowadays, however, the possibility of alterations is generally admitted.

In view of the scanty regulation as to the articles (certificate) of incorporation, the enactment of by-laws is a necessity, and some statutes expressly require such enactment, though in the absence of such provisions there is no legal compulsion to adopt by-laws. On the other hand, before the enactment of general corporation laws, it was held at common law that corporations have an inherent power to adopt by-laws and that such power is one of the legal incidents of their creation; they may thus adopt by-laws even without express authorisation in the charter (articles or certificate of incorporation) or by the general corporation law of the State. The by-laws, however, cannot be contrary to the charter (articles or certificate of incorporation), nor may they overrule the limitations imposed by the general corporation law. Similarly they are void if contrary to public policy.

It has been held in many cases that to be valid by-laws must be reasonable and not arbitrary or oppressive. These generalisations will be examined in connection with the question of the protection of minorities.

The power to enact by-laws is vested in the shareholders, but may be delegated to the board of directors. Where the board have power to enact by-laws, they may also amend or repeal them. In some States the power to make, amend and repeal by-laws is vested in the board of directors.

Although under most State legislations the enactment, amendment, and repeal of by-laws is to be certified and filed with the competent authority, it is held that third parties are not affected by constructive notice, and that the provisions are not operative as against them unless it is proved that they had actual notice of the by-laws at the relevant time—generally when they made the contract. Furthermore, the Courts take no judicial notice of by-laws; they must be proved by the party who makes the allegation.

On the limits of the power to make by-laws and to alter them by majority resolutions, see § 78, Vol. II (cf. Ballantine, sec. 188).

The legislations of the European Continent, with two exceptions, adopted the principle of a single instrument to contain the regulations for management, usually called the Statutes of the company (*statuts*, *Statuten*, in German law *Satzung*), which is to be enacted at the company's formation and may subsequently

be amended by the shareholders in general meeting, usually with more or less strict formalities. A delegation of this power is held inadmissible, except for corrections of minor importance.

The laws define the minimum of matters to be regulated in the articles; they may, and in most cases do, contain other regulative provisions. The provisions of the various laws are on the whole similar, and therefore only some of the most important are quoted.

Originally the French Company Law dealt with the articles of association indirectly by prescribing that subscriptions to the capital are to be made on a form of declaration which must contain the particulars to be laid down in the articles (sec. 1, law of 1867). The law-decree of 31 August 1937, however, provided that a draft of the articles (*statuts*), signed by the promoters, is to be filed with the Tribunal de Commerce before subscriptions are opened. The draft is open for inspection by the general public. The declaration of subscription (*Bulletin de souscription*) must state:

(1) The name of the company.
(2) The place of its registered office (seat).
(3) A summary definition of its purposes.
(4) If the capital is to be raised by an appeal to the public, a reference to the publication required.
(5) A statement as to what part of the capital is to be paid in cash and what by transfer of property.
(6) The place where the payments in cash are to be made.

By German Company law the Articles (*Satzung*) must state:

(1) The name and seat of the company.
(2) The object of the undertaking.
(3) The amount of the capital.
(4) The nominal value of the shares and, where there are several classes of shares, the provisions relating thereto.
(5) The composition of the management.
(6) The form of the communications to be made by the company (§ 16 (3)).

There are also certain stipulations which are valid only if inserted in the articles. This is the case, e.g. with stipulations regarding advantages promised to individual shareholders, to the expenses of promotion and contributions of property (§§ 19, 20). The articles are to be completed in judicial or notarial form.

Whether the incorporators (promoters: *Gründer*) take up all the shares or whether part of the capital is to be raised by

subscription, the articles are to be fixed by the *Gründer*. The subscribers may refuse to form the company if they are dissatisfied with the articles.

The provisions of the Swiss law are more elaborate in detail (sec. 626), and two questions are settled on a different basis. If the promoters have not taken up all the shares, so that a part of the capital is to be raised by subscriptions, it is the constituent meeting which has to fix the articles (*Statuten*), the promoters merely submitting a draft thereof. Secondly, for any substantial alterations in the draft articles unanimous assent of all subscribers present is required (secs. 634, 635).

Hungarian law regards the memorandum of association as the basis of the company and the first step to its formation. The memorandum, called the prospectus—literally the draft of the company—has to state:

(1) The object of the undertaking and its duration.
(2) The amount of the capital.
(3) The number and nominal value of the shares and of the bonds, if bonds are issued simultaneously.
(4) The date for the closing of subscription lists.
(5) If shares are to be issued for property, particulars of such property and its value.
(6) The advantages to be granted to the promoters or any other person.

The "draft" therefore occupies in Hungarian law the place both of the memorandum of association and of a prospectus. It is to be drawn up and signed by the promoters, whether they take up all the shares or make an appeal to the public for part or the whole of the capital. A copy of the memorandum signed by the promoters is to be attached to every subscription list (§ 150). Besides this memorandum a draft of the articles is to be submitted to the constituent meeting, which has to resolve upon its acceptance or any amendment of it. The articles must contain, besides the particulars given in the memorandum under Nos. 1–3, 5 and 6 above, a number of provisions strictly defined by the law (§ 157 (1)–(115)).

The position under Swedish law is similar. The law of 1944 maintains a distinction between the memorandum, called the "Founding Document" (*Stiftelse Urkunden*) and the articles, called the "Company regulation" (*Bolagsordningen*). The minimum contents of both documents are defined by the law in secs. 6 and 7

for the memorandum and in sec. 8 for the articles. The memorandum is to be drawn up by the founders (promoters, cf. § 47), and the articles are to be fixed by the constituent meeting, which has to decide on the draft presented by the founders.

In spite of differences in detail the general trend of evolution is on the whole similar everywhere. At first the regulation was regarded as fixed and unalterable, unless by an act of the Sovereign or the legislature. The second stage was that alteration was allowed in case of unanimous consent. The third phase, which prevails at present, is that the regulation may be altered by a majority resolution, except in so far as this is prohibited in order to protect the interests of a specific minority, or in certain cases even of the individual shareholder.

40. Publicity

One of the most important considerations affecting the business corporation is that of publicity. Not only the shareholders, but also the general public, must be able to obtain information about the corporation's existence and activities. Even under the system of creation by special charter there were provisions tending to this end. With the acceptance of the principle of free formation its importance increased, and nowadays it is paramount.

Publicity is secured by record, generally in a special register of companies, or—as under the legislations within the German orbit—in a special part of the general trade register. Every company that is formed must be registered; registration completes the incorporation. Before or in default of registration the company remains unincorporated, with all the consequences attached thereto.

The register of companies is invariably kept by a public officer; in Great Britain the Registrar of Companies, in the U.S.A. as a rule the department of the Secretary of State. Under the European laws the register is entrusted to some special division of the Courts, and it is decentralised, each Court administering those corporations whose registered offices (seats) are within its district, whereas in countries where registration lies with an administrative body, there is more or less concentration. Thus in Great Britain there are two registers: one for England and Wales, and one for Scotland. In the U.S.A. there is generally a separate register for each State.

Publicity further means that on application for registration the relevant documents are to be filed, i.e. presented to the authority which keeps the register, and retained by it. The relevant items recorded in these documents are entered in the register, both the register itself and the documents being open to inspection. Generally, not only shareholders or persons who can prove some legitimate interest in the company's affairs, as creditors or otherwise, but any member of the public is entitled to inspect the register and other documents, and to obtain simple or certified copies of them on payment of fees, generally of moderate amount. The German Commercial Code (§ 9) allows copies of documents to be taken only on showing probable legitimate interest. This and other like restrictions of course tend to impair the interests of the general public, which should enjoy all possible facilities for information.

As a rule the body which keeps the register of companies must scrutinise applications for incorporation and accompanying documents to satisfy itself that the legal requirements have been complied with, must decline registration in case of failure, and must require such amendments or additions as it may find proper. In consequence, registration is generally regarded as *prima facie* evidence of compliance with the law, and alleged irregularities must be proved. Moreover there is a tendency to hold that the fact of registration ought to exclude any collateral attack, and even have *per se* the effect of atoning for irregularities (cf. § 48).

Alterations in the structure of a corporation during its life are also to be recorded, the requirements in this respect varying. There are also differences in technicalities: such as whether and how far the particulars are to be entered in the register or are merely to be reported, in which latter case the reports and attached documents are made available to inspection by the general public.

Most legislations also provide for the insertion of certain particulars in the official Gazette of the State or in a special journal devoted to companies. Some also require every corporation to select one or more newspapers for its communications and to name those newspapers in its articles, so that the public can obtain knowledge of the facts through them.

Compliance with these provisions is generally enforced by fines on the directors. It is sometimes also provided that a corporation which fails to register or publish a relevant fact

cannot assert it as against a third party unless it is proved that the party in question had actual notice of the omitted fact.

Conversely the question arises whether and how far registration implies constructive notice, i.e. whether the public are under obligation to gather information from the register and fail to do so at their own risk, or whether actual notice is to be proved. In this respect too the attitude of the various legislations differs widely.

Publicity also extends in some degree to corporation accounts. This is not identical with the obligation to give information to shareholders on the state of affairs and the results of management (see § 88, Vol. II). Corporations are generally obliged to file their accounts with the person or body entrusted with registration. The accounts so filed are open to public inspection, at least to those who assert a legitimate interest. Some legislations also require publication of the yearly accounts, i.e. the balance sheets, with or without the profit and loss accounts.

This publicity of accounts is of great importance from the point of view of actual or prospective shareholders and creditors, and of the general public. It also provides information for the financial press, which, if painstaking and honest, can give important service. In some countries, such as Great Britain and the U.S.A., the financial press is of high moral and professional standing. In some others the knowledge and competence ot financial editors and contributors is not so high, and sometimes in some places rumours of prejudice or corruption in the financial press have spread, not without reason. The importance of an independent, competent and incorruptible financial press cannot be overstressed.

There are some exemptions from the obligation to file accounts. Thus in Great Britain private companies as a rule are not bound to do so. The same rule holds where the private company is governed by special laws, as with the G.m.b.H. in the German orbit or the *Société à responsabilité limitée* in France. Whether this is to be approved from the point of view of legislative policy will be examined in § 83, Vol. II. The question of how far the existing provisions ensure that balance sheets and profit and loss accounts are really informative is discussed in §§ 85 and 86, Vol II.

CHAPTER II

THE FORMATION OF COMPANIES

41. Preliminary Remarks

In Part I of this work it has been shown that the creation of corporations was originally effected by special procedures—charters, letters patent from the Sovereign or special Statutes. The regulations applying to the corporation were in each case defined by the charter; there was no general law covering all business corporations, and the rules laid down in the charters were scanty. Only a very few rules were evolved by the Courts, which in Britain and the U.S.A. applied and elaborated the general principles of the Common Law. This system was called by European authors the Octroi system. As the number of incorporations increased, this proved cumbersome, and it became necessary nearly everywhere to evolve general rules.

In Europe this was usually done by enactments which laid down leading principles for the regulation of corporate life; but a special charter was nevertheless still required for each incorporation. As we have seen, the *Code de Commerce* adopted this method for the *société anonyme*, and its example was followed by the governments of the German States. German authors called this method the concessions system.

In Britain and several States of the U.S.A. the necessity of government franchises was dispensed with about the middle of the 19th century, except where the object of the enterprise required a specific franchise, as with railways, canals, and other public undertakings. In Britain special Acts were passed for each class of companies that needed such special franchises, such as the Companies Clauses Consolidation Act (8 & 9 Vic., c. 16) and the later Acts mentioned in § 9. The regulation of each single company was covered by the general Act applying to its class, though nothing prevented Parliament from enacting special provisions when required. For companies in general, 7 & 8 Vic., c. 110, made incorporation by registration possible without specific governmental action, though at first only with unlimited liability; the acquisition of a so-called general franchise was thus

made free. The first steps towards authorising limited liability were not taken until 1855 and 1856.

In 1867 France adopted the same principle, and in Germany, where the Commercial Code of 1861 had left it to each State of the Confederation to choose whether to retain the requirement of special concessions or to make registration of companies free, the law of 1870 dispensed with special concessions. Thenceforth most legislations adopted the principle of free incorporation, the so-called normative system, and in only a few countries is a special concession in each case still required. Austria retained this requirement until the arbitrary imposition of German Company Law in 1938: in the Netherlands it still holds.

Whereas the formation of companies and the possibility of corporate existence depends nowadays on the free volition of the incorporators, the purpose and object of a company may in certain cases require a grant or permit from the appropriate governmental body, or, as it is called in America, a special franchise.

Freedom of incorporation, however, does not mean that the formation of companies is not subject to regulation. In fact the rules governing it are highly elaborate; but so long as the incorporators comply with them the company comes into being by virtue of the general law.

The State's attitude may be not to exercise any supervision over the creation of companies; the incorporators are then left to their own judgment whether they have complied with legal requirements, the corporation being either valid or invalid accordingly. It will then be a matter for subsequent judicial scrutiny and decision whether the company has or has not been lawfully formed. Such an attitude, however, is inadequate. It is hardly reasonable that shareholders and creditors, actual and prospective, should be left in doubt whether the company has been duly formed in compliance with the law. The shareholders, the creditors and the general public have a right to know whether they can or cannot rely on its legal validity. This general interest in the question of validity requires some kind of preliminary supervision in order to ascertain whether the legal requirements have or have not been complied with. This supervision, as we saw in § 40, is entrusted in some countries to administrative and in others to judicial bodies.

Consequently, whereas in Britain, and so far as State jurisdiction goes, in the U.S.A. also, the administration of the Register

and the supervision previous to incorporation is more or less centralised; on the Continent decentralisation prevails, a state of affairs which is not conducive to unity and consistency in practical handling.

A further question is how far defects incurred during the formation of a company may or may not be asserted after its registration (see § 48).

Recently a new legislative approach towards corporate enterprise has been evolving. During the Second World War governments assumed control of the capital market in greater or less degree, and made appeals to the public for capital in the form of shares and debentures dependent upon governmental permission, while financing by borrowing was also more or less under the control of the governments or National Banks of the countries concerned.

Certain governments are now tending, since the end of hostilities, to perpetuate this wartime measure as an instrument of planned economy.

42. Formalities of Creation, especially the Constituent Act

For a corporation to come into existence it is necessary for a certain number of persons to decide on its formation, for its constitution to be laid down, for a certain capital to be secured, for a minimum of organisation to be provided and subsequently for the formation to be registered by the appropriate authority.

The regulations made under the various systems may differ with the circumstances of the case, especially according as the capital is provided by the parties to the constituent act or by appeal to the public, whether it is paid up exclusively in cash or wholly or in part by transfer of property. The simplest case is that in which the whole capital is provided in cash and no public appeal is made.

The requirements of British law in such a case are very simple. Seven—or in the case of a private company two—persons must subscribe their names to a memorandum of association, each of them taking up at least one share; they must submit a statutory declaration signed by a solicitor or by a person named in the articles as a director, stating that the requirements of the Companies Act have been complied with; they must file, together

with the memorandum and declaration, a statement giving the nominal capital, the address of the registered office, and particulars as to the directors.

If these documents comply with the Act the company is to be registered and will come into existence by virtue of its registration.

We have to remember that, however large the nominal capital may be, it is not necessary for more than seven—or in the case of private companies two—shares to be subscribed, and it is not necessary for registration that any part of the nominal value of the shares should be paid up. The remainder of the shares, i.e. those not subscribed by the signatories to the memorandum, may be placed at any time, and the unpaid part of the shares may be called up subsequently at the company's convenience.

In order, however, to begin business and to be able to allot shares, a public company, if it makes an appeal to the public for subscription, must issue a prospectus; if it does not make such an appeal, it must file a statement in lieu of a prospectus. Even in the case of an appeal to the public it is left to the company, if it thinks fit, to allot only a certain portion of the capital and to postpone the issue of the remainder. On the other hand the fixing of the method of payment is not entirely free: the amount payable on application, i.e. before allotment, may not be less than 5 per cent. of the nominal value of each share to be issued. Under Continental legislation, on the other hand, the whole capital has as a rule to be subscribed, and a certain percentage of it and of each share is to be paid up. Furthermore the requirements as to the organisation of the company are more elaborate.

I. MEMORANDUM AND ARTICLES

In Great Britain the adoption of a Memorandum of Association is essential; without one no company may come into existence. A company limited by shares, however, may or may not have Articles of Association. If a company dispenses with articles, the regulations contained in the standard form of articles set forth in Table A of the Companies Act apply. A company may on the other hand adopt all or any of the regulations of Table A, in which case those regulations will apply only in so far as they are not expressly excluded or modified by the articles registered

by the company (sec. 8). In practice, however, most companies frame articles with provisions either identical with or deviating more or less from those of Table A as their special purposes and circumstances may require.

The original view was that the memorandum is the basis of the company's corporate existence, in the sense that its contents could not be altered except by unanimous consent of the shareholders, whereas the provisions of the articles were alterable by special resolution. Formally this principle still prevails, and sec. 4 of the Act of 1929 stated that "a company may not alter the conditions contained in its memorandum". It is only as an exception that such alteration is stated to be possible, and express provision is made as to its mode and extent. Articles, on the other hand, may be altered, or new provisions added to them, by special resolution (sec. 10 (1)). Such alterations have the same binding effect as the original articles, and may themselves likewise be altered by special resolution (sec. 10 (2)).

Nowadays, however, almost all the provisions of the memorandum are alterable either unconditionally or, in the case of the objects clause, subject to the assent of the Court.

The Companies Act 1947 (secs. 77 and 78) took a further step to facilitate alterations of the memorandum. Confirmation by the Court is as a rule not required, and power is given to alter provisions which were included in the memorandum, though they could lawfully have been contained in the articles (see secs. 5 and 21 of the Companies Act 1948 and § 78, Vol. II).

Both memorandum and articles must be signed by at least seven persons, or if there be more than seven subscribers to the memorandum, by all of these, in the presence of at least one witness, and both must be stamped in the same manner as a deed. The articles must be printed in every case, whereas the memorandum may be in writing. In practice, however, memoranda are almost always printed. Finally, the articles must be divided into consecutive sections.

Both memorandum and articles, if any, are to be delivered to the Registrar of Companies, who is to retain and register them (sec. 12). Both are open to inspection by the general public without showing special interest, and any person may demand a copy of the whole or part for a small fee (sec. 426 (1)). Both are therefore public documents, and every one who comes into contact with the company is considered to "be affected with

notice of all that is contained in those two documents".[1] This principle was recognised even before the Act of 1862.[2] This of course means that the constructive notice is operative according to the proper meaning of the documents; no one can assert that he did not understand them or attributed to them some other meaning.[3]

So long as the memorandum and articles remain in force they are binding on the company and on its shareholders. This means that rights and obligations as between the company and its shareholders are governed by them. By sec. 20 (1) "subject to the provisions of this Act the memorandum and articles shall, when registered, bind the company and the members thereof to the same effect as if they respectively have been signed and sealed by each member".

Sec. 20 (2) expressly states that "all money payable by any member to the company under the memorandum and articles shall be a debt due from him to the company and in England be of the nature of a specialty debt". We must remember that the obligation to pay the par value of the shares or calls was originally not actionable, and the company's only remedy was to make the shares forfeit. On the other hand the articles bind the company as against the shareholder, who is entitled to demand that the company observe the provisions of the memorandum and articles as far as he is concerned. It is held [4] that a shareholder has the right to contest a forfeiture of his shares not complying strictly with the provisions contained in the regulations. In Oakland Oil Co. *v.* Crum,[5] it was recognised that the shareholder has an actionable right to insist on compliance with the articles as to dividends so long as the provisions referring to them are not altered, which, however, may be done for the future. In Wood *v.* Odessa Waterworks Co.[6] an injunction was granted against

[1] *Per* Lord Hatherley, in Mahony *v.* East Holyford Mining Co. (1875), L.R. 7 H.L. 869, p. 893.

[2] Ernest *v.* Nicholls (1857), 6 H.L.C. 401, followed under that Act in Sewell's case *in re* New Zealand and Banking Corporation (1868), L.R. 3 Ch. App. 131, and further in Campbell's case, Bank of Hindustan, etc. (1873), 9 Ch. App. 1, and in the Mahony case quoted.

[3] Griffith *v.* Paget (1877), 6 Ch. D. 511; Oakbank Oil Co. *v.* Crum (1882), 8 App. Cas. 65, p. 71; cf. also Marshall *v.* Glamorgan Iron and Coal Co. (1868), L.R. 7 Eq. 137, Barrow Haematite Steel Co. (1888), 39 Ch. D. 582; Argus Life Assurance Co. (1888), 39 Ch. D. 571; County of Gloucester Bank *v.* Rudry, etc., Co. (1895), 1 Ch. 629; Owen and Ashworth's Claim (1901), 1 Ch. 115.

[4] Johnson *v.* Lyttle's Iron Agency (1877), 5 Ch. D. 687, C.A.

[5] (1882), 8 App. Cas. 65.

[6] (1889), 42 Ch. D. 636.

the company to restrain it from violating the articles, and in Burdett *v.* Standard Exploration Co.[1] it was held that a shareholder may enforce the issue of a share certificate to himself if the articles give him such a right.

The articles, however, do not give rights to third parties in the absence of a contract. In Eley *v.* Positive, etc., Co.[2] it was held that a clause in the articles providing that the plaintiff should be employed for life as solicitor to the company may give him no right to sue for damages in case of dismissal. This doctrine was extended to cases in which the other party was a shareholder, but the provision related to some matter other than his rights and duties as such. Thus in Browne *v.* La Trinidad,[3] it was held that though the articles contained a clause to the effect that a contract made before incorporation should be adopted by the company, the confirmation of the articles constitutes no contract with the other party, although in that case shares were allotted to him and he was consequently a member.

Similarly, a clause in the articles prescribing arbitration in case of disputes between the company and its members does not amount to a written agreement for submission to arbitration of a dispute between the company and a director.[4]

The insertion into the articles of a clause in favour of some person coupled with action in reliance on it and entering into relations with the company may, however, constitute an implied contract.[5]

The question of alterations in the memorandum and articles, how they are affected and within what limits they are possible, will be examined separately (§ 78, Vol. II).

Neither memorandum nor articles may be contrary to law, and should they be so the stipulation concerned is void.

As between articles and memorandum, the memorandum prevails. "The memorandum is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit."[6] On the other hand the articles may be used to explain the memorandum, though such explanation and construction may not be used so as to extend the objects

[1] (1895), 16 T.L.R.
[2] (1876), 1 Ex. D. 88.
[3] (1887), 37 Ch. D. 1.
[4] Beattie *v.* Beattie (1938), Ch. 708.
[5] Swabey *v.* Port Darwin Gold Mining Co. (1889), 1 Meg. 385; *in re* International Cable Co. (1892), 66 L.T. 253; and *ex parte* Beckwith (1898), 1 Ch. 324.
[6] *Per* Lord Cairns in Ashbury Railway, etc., Co. *v.* Riche (1875), L.R. 7 H.L. 635.

of the company, and generally such construction cannot be applied to those provisions which under the Act are to be inserted into the memorandum.[1]

In application of these principles it has been held that the articles cannot give a company the right to purchase its own shares,[2] to pay dividends out of capital,[3] to extend its objects by special resolution unless within the limits of the law,[4] to issue shares at a discount otherwise than is authorised by the Act,[5] to prohibit the shareholders from applying for a winding-up order,[6] to provide for the application of the profits in a manner inconsistent with the memorandum[7] or to deprive shareholders who dissent from a scheme of reconstruction of their statutory right to be paid out in cash.[8]

The provisions of the Companies Acts of the States of the British Commonwealth are either completely or substantially identical. Under the Companies Act of Canada an application is to be submitted to the Secretary of State, together with the memorandum of association signed by at least three persons, for the grant of a charter by issue of letters patent (5). The provisions as to the contents of the application are more explicit than those relating to the memorandum. These two documents give the company its basic framework. Their contents are to be recited in the letters patent to such extent as seems expedient to the Secretary of State (8).

The contents of the application are defined in the Act in such detail (7 (1)) that articles (called by the Act by-laws) may in many cases not be necessary. Applicants for a charter may, however, draw up by-laws, and may ask to have embodied in the letters patent any provision which could be included in any by-law (7 (3)).

Under the State legislations of the U.S.A., the incorporation is effected by depositing the articles of association, called in several States the Certificate of Incorporation. The deposit, as already mentioned, is in most States to be made with the Secretary of

[1] Anderson's Case (1881), 17 Ch. D. 373, and Guinness *v.* Land Corporation of Ireland (1882), 22 Ch. D. 349.

[2] Trevor *v.* Whitworth (1887), L.R. 12 App. Cas. 409.

[3] Guinness *v.* Land Corporation of Ireland, *supra.*

[4] Ashbury Railway, etc., Co. *v.* Riche (1875), L.R. 7 H.L. 635.

[5] Welton *v.* Saffery (1897), A.C. 299.

[6] *Re* Peveril Gold Mines (1898), 1 Ch. 122.

[7] Ashbury *v.* Watson (1885), 30 Ch. D. 376.

[8] Baring Gould *v.* Sharpington, etc., Synd. (1899), 2 Ch. 80; Payne *v.* Cork Co. (1900), 1 Ch. 308.

State. The procedure is on the whole as simple as in Great Britain. Some States, however, prescribe a minimum of capital and also a minimum quota of payment thereof. The articles (certificate) of incorporation, after acceptance by the Secretary of State or the competent Department, are frequently called the Charter of the corporation, a relic of the days previous to the adoption of general corporation laws.

The textbooks discuss at considerable length the question whether a charter is valid and binding on the corporation only if it is accepted. In practice, however, incorporation is nowadays granted in most cases on application by the incorporators, and subsequent acceptance of the charter is quite superfluous. This is explained as meaning that acceptance of the charter is declared beforehand.

Further, it is stressed that the charter cannot be contrary to the law, and that the provisions of the general Corporation law of the State concerned operate to supplement the contents of the charter, i.e. the articles or certificate of incorporation, both together constituting the basis of the regulation.

It is usual to adopt by-laws in order to provide for detailed regulations for the management; but only in certain States is this insisted on. It is held that the by-laws cannot be contradictory of the charter (articles or certificate of incorporation).

As we have seen above, the power to enact by-laws may under certain legislations be delegated to the board of directors, and a few general corporation laws give this power to the board. The provisions of the various State legislations differ in many minor details which it would be cumbersome to enumerate. A meeting of the incorporators before incorporation is generally not required, and many of the details of organisation may be settled after incorporation.[1]

Most European legislations do not require a memorandum, but only the adoption of articles. The procedure of incorporation is complicated by the attitude of the laws concerned as to the subscription and payment of capital. It is generally required that each share be fully subscribed and that a minimum must be paid on it. There are two notable exceptions. The Swedish law since 1895 has allowed that instead of a definite fixed capital a company may have a minimum and maximum capital, so that it may issue additional shares until the maximum is reached

[1] Ballantine, ss. 13–19.

without resorting to the special machinery for capital increase. The minimum, however, may not be less than two-thirds of the maximum (sec. 2). Similarly the German law of 1937, by introducing "authorised capital", permitted the articles to authorise the board of management to issue within the first five years, without a resolution for an increase of the capital, shares up to 50 per cent. of the capital issued (§ 169 (1)).

Under most European systems the articles have to be adopted by the subscribers in general meeting.

German law, in cases where the whole capital is taken up, the so-called "simultaneous creation" (*Simultangründung*) allows that the company may be created by laying down the articles in a judicial or notarial document, provided that the subscription of the whole capital is to be contained in the same or another document likewise executed in judicial or notarial form. At the same time the members of the first board (council) of supervision are to be appointed in a document in similar form (§§ 22, 23). The company, however, cannot be incorporated without at least one-quarter of the nominal value of each share and the full amount of the premium, if any, being paid up (§ 28 (2)).

This German example is followed by the Swiss legislation. Here a company may be formed by executing a public (i.e. judicial or notarial) document settling the articles, containing a declaration by the signatories that they are taking up the whole capital, a statement that at least 20 per cent. of the nominal value of the shares is paid in cash, and lastly appointing the board of directors and at least one auditor or "revisor" (638, 633, 424).

All other Continental laws require that the articles should be adopted by the shareholders in a general meeting, usually called the constituent meeting.

Under some legislations judicial or notarial form is not necessary. The payment of a certain part of the minimum value is generally required. In many countries this is one-fourth: in Hungary it is 30 per cent, of which at least 10 per cent. is to be paid on subscription, and the remainder before application for registration.

Except under the German and Swiss laws, subscriptions are to be made on separate subscription lists, even if all the shares are taken up by the promoters.

II. CORPORATE NAME

This question has been discussed in § 38.

III. REGISTERED OFFICE (SEAT)

Every business corporation must have a place from which its affairs are managed—the centre of its business activities, the equivalent of the domicile of a natural person. But a corporation must fix that place in advance, and its decision must be made known to the authorities and to the general public.

Under British law every company must have a "registered office". The Companies Act (sec. 2 (1) (*b*)) requires that the memorandum of association should state whether this is situated in England or Scotland, and on this it depends whether the company is registered in London or Edinburgh. The company may be incorporated even if nothing more than this as to its registered office is recorded for the time being. But within 14 days from the day of incorporation or at the commencement of business, whichever is the earlier, it must acquire a registered office and give notice of its situation, and of every subsequent change, to the Registrar, who will make a record thereof. The inclusion of a statement on this point in the annual return does not suffice, and the company and every officer in default are liable to a fine for failure to comply with the rule (sec. 107).

If, at the time of presenting the memorandum and other documents for registration, the incorporators have not yet decided where the registered office is to be, they may postpone the statement thereof, but they must make such a statement within the said two weeks. They are free to choose any place within England or Scotland respectively. The statement that the registered office is in England or in Scotland is unalterable except by Act of Parliament, but the company is free to choose or to change its registered office within the designated territory.

To the registered office all communications and notices for the company may be addressed (sec. 107 (1)), and a document or legal process may be served on a company by leaving it at or posting it to its registered office (sec. 437). The same was held under the Act of 1862.[1] Although in general documents may be served at other places if they reach the directors or other

[1] White *v.* Land, etc., Co., W.N. (1883), 174.

officers, it has been held that service of a summons for a punishable offence must be effected at the registered office.[1]

The register of members as a rule (sec. 110), of directors (sec. 200) and of mortgages are to be kept at the registered office, as well as the copies of registered documents and the minutes of general meetings (sec. 146). The right of inspection within the terms and limits of the Act is to be exercised at that office. Lastly the balance sheets of banking, insurance and certain other companies are to be exhibited in a conspicuous place at their registered office, whether any business is carried on there or not (sec. 437).

The company is not bound to establish its registered office at the place where its business is wholly or mainly carried on, though this is often done. There is no objection to the registered office being in a place where only a small part of the company's business, or even none at all, is effected, should that be found convenient.

In the U.S.A. the material question is under the laws of what State a corporation has been created, as for certain purposes it is regarded as a citizen of that State. This applies mainly to questions of jurisdiction, especially of Federal jurisdiction.

Within the State the domicile of a corporation is at the place where it has its principal office or place of business. But a corporation incorporated in a given State may extend its activities to another State, and have its plants, shops and offices and to engage in business there provided the State concerned gives its assent. Some States require a licence and others even a charter for this purpose. The fact that such a licence or charter is required does not affect the so-called citizenship of the corporation, which is always in the State where it was created.

We have already seen (§ 22) that a large number of corporations—among them many of the largest—have sought incorporation in one of the smaller States, such as New Jersey or Delaware, whereas their business is carried on mainly, or even solely, in other States. In such circumstances many disputes arise, especially in respect of jurisdiction and taxation. These questions fall under the head of Foreign Corporation Law, and the details are outside the scope of this work. We therefore need only say that neither in matter of jurisdiction nor taxation is the rule of the exclusive citizenship of the State of incorporation strictly observed.[2]

[1] Pearks Gunston and Tee *v.* Richardson (1902), 1 K.B. 91.

[2] Cf. Ballantine (1st ed.), s. 7.

Under the laws of the European Continent the company's headquarters is called its "seat" (*siège social, Sitz*). Every company must have a seat, which must be chosen before incorporation, and its location stated in the articles. The seat must be situated within the State, and no company may be registered which has its seat outside the State. The entry in the Register of Companies must include the provision as to the seat, as must also the publication which is provided for under most legislations. The seat may be transferred within the State by a special resolution and a corresponding alteration of the articles. Transfer to a place abroad, however, is not as a rule admitted except by special authorisation of the legislature or government.

By German law a company could choose its seat at its convenience, and it was not necessary that the business should be mainly carried on there. Whether the choice of a seat at which no business was carried on was valid was disputed. The prevailing view seems to be that the provisions of the articles are decisive even in such a case. The difficulties arising from the choice of such an arbitrary and, as some authors put it, "fictive" place were mitigated by a provision of the Civil Procedure Code under which a company might also be sued at the place or places where it carried on business. Complaints arose that certain companies abused their freedom to fix their seat where they thought fit by choosing small townships or villages in order to make supervision difficult, and § 5 of the German law of 1937 provides that the seat must as a rule be at a place where the company has an establishment (plant or trading office), or from which its business is directed, or where its management is situated. The commentators hold that the Court may sanction the choice of another place if legitimate interests require it. It is assumed that the Court may not register the company if its seat has been chosen in violation of the provision, and even that the registration may be cancelled on the action of a shareholder or ex-officer in case of non-compliance with an order of the Court.

Under French law the majority rule is that an arbitrary choice of seat is inoperative and that the place from which the affairs of the company are managed or, according to another view, where the larger part of the business is carried on, is to be regarded as the seat of the company. (Pic, 191, 192.)

In view of the decentralisation of the Register of Companies which prevails on the Continent it is generally provided that

branches are to be registered in the Register of the competent Court. But it is a matter of dispute what kind of business is required to be carried on for the establishment to be regarded as a branch. Places where merely menial work is performed need not be registered, but only those where contracts or business deals are made.

As foreign corporation law is beyond the scope of this work, we shall not discuss the question of the nationality or the conditions under which the law allows foreign corporations to carry on business and establish branches within the State. The same applies to the questions connected with wartime legislation and especially to the various Trading with the Enemy laws.

43. IV. Objects and Other Clauses

It is universally agreed that the objects of a corporation are to be defined on its formation by the constituent act. We must bear in mind that the objects as so defined were originally held to be unalterable except by the issue of a new charter; but nowadays alterations are allowed under more or less elaborate safeguards, and the tendency is to make such alterations easier. Under British law it is in the memorandum of association that the objects of the company are to be stated (sec. 2 (1) (*c*)).

The object may be any lawful purpose; the registration of companies with unlawful purposes is to be refused. But if by inadvertence a company with an unlawful purpose has been registered, the registration does not entitle the company to fulfil that purpose. It is to be dissolved, or, should it have one or more lawful purposes as well, compelled to discontinue the pursuit of the unlawful one. What is unlawful is governed by the general rules applying to the legality of contracts.[1]

It is illegal for a company to pursue objects in restraint of trade.[2] It is further illegal for a trade union to register as a company.[3] It has been held that an association to protect copyright is not to be regarded as a trade union,[4] whereas a trade combination to control prices may be so regarded from the point of the Companies Act.[5]

[1] Cf. Pollock-Winfield, *Contracts*, Ch. VIII.
[2] Joseph Evans & Co. *v.* Heathcote (1918), 1 K.B. 418; McEllistrim *v.* Ballymacelligott Co-operative, etc., Society (1919), A.C. 548.
[3] Trade Union Act, 34 & 35 Vic., c. 31, s. 5, as referred to in s. 459.
[4] Performing Right Society *v.* London Theatre of Varieties (1922), 2 K.B. 433.
[5] Joseph Evans & Co. *v.* Heathcote, *supra.*

As we saw in Part I, registered and statutory companies may not pursue any other purposes than those stated in the memorandum, but this rule does not apply to chartered companies. Both registered and statutory companies, however, are empowered to carry on those businesses for which they were formed according to the objects clause in their memorandum, and "to do whatever may fairly be regarded as incidental or consequential to them",[1] and, as Lord Cairns stated:[2] "the clause contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation, and it states, if it is necessary so to state, negatively that nothing shall be done beyond this ambit and that no attempt shall be made to use the corporate life for any other purpose than that which is so specified." It is to be remembered that at that time the memorandum, and particularly the objects clause, could not be altered. Only in 1908 was alteration of the objects clause, subject to the sanction of the Court, made possible by sec. 9 of 8 Edw. VII, c. 69.

"What has or has not been stated as object of the corporation must be found by fairly reading its words and a reasonable interpretation of the language which the memorandum employs."[3]

The clauses are to be interpreted according to the general rules governing the interpretation and construction of documents. The numerous judgments in which objects clauses have been construed show clearly that with the passing of time an increasingly liberal and broad view has been taken by the Courts. The same trend appears in respect of the question of what activities are to be regarded as incidental or consequential to the object as defined in the memorandum.

The importance of a fair and reasonable construction of individual objects clauses and the decision whether a contract can be regarded as ancillary or consequential to the object of the company lies in the doctrine of *ultra vires*, under which a contract which is beyond the ambit of the company's activities

[1] *Per* Lord Selborne in Attorney-General *v.* Great Eastern Rail. Co. (1880), L.R. 5 App. Cas. 473.

[2] Ashbury Railway Carriage and Iron Co. *v.* Riche (1875), L.R. 7 H.L. 653, p. 670.

[3] *Per* Lord Macmillan in Egyptian Salt and Soda Co. *v.* Port Said Salt Assoc. (1931), A.C. 677, p. 682.

is void and not binding upon the company.[1] Halsbury stated [2] that "those two cases do constitute the law upon the subject".

Further it has been held that it is extremely difficult to imply from the memorandum power to acquire a similar business; [3] and that agreements for sharing profits, joint adventure or other arrangements to the same effect require very clear powers.[4]

As a rule special powers are necessary in order to take shares in other companies having similar objects.[5] This power, however, has been held to be implied in a clause of the memorandum allowing amalgamations.[6] Promotion of companies for a purpose calculated to benefit the company was held not to be implied.[7]

The question of borrowing powers has been specially disputed. In the case of trading companies they are held to be implied.[8] In the case of non-trading companies, however, express power is generally required to make the contract valid.[9]

In earlier times it was fairly usual to restrict the borrowing power of the company to a specific sum. In such a case any borrowing in excess of the amount specified would be *ultra vires*. Nowadays, however, such restriction of borrowing power is practically unknown (see § 65, Vol. II).

If a company has power to borrow it has also the right to mortgage or otherwise charge its uncalled capital.[10] A clause authorising the mortgaging of the property and rights of the company was held to be sufficient to this effect;[11] also the words "to mortgage the assets";[12] or to raise money by "various

[1] Ashbury Railway Carriage and Iron Co. *v.* Riche (1875), L.R. 7 H.L. 653, followed in Attorney-General *v.* Great Eastern Rail Co. (1880), L.R. 5 App. Cas. 473, in which case, as already noted, the importance of reasonable construction was stressed.

[2] London County Council *v.* Attorney-General (1902), A.C. 165.

[3] Ernest *v.* Nicholls (1857), 6 H.L. Cas. 401.

[4] *In re* European Society Arbitration Acts; *ex parte* British Nation Life Insurance Association (1878), 8 Ch. D. 679.

[5] Barned's Banking Co. (1867), L.R. 3 Ch. App. 105, and Lands Allotment Co. (1894), 1 Ch. 616.

[6] *Re* William Thomas & Co. (1915), 1 Ch. 325.

[7] Joint Stock Discount Co. *v.* Brown (1869), L.R. 8 Equ. 381.

[8] Bryon *v.* Metropolitan Saloon Omnibus Co. (1858), 3 De G. & J. 123; *ex parte* City Bank (1868), L.R. 3 Ch. App. 758; General Auction, etc., Co. *v.* Smith (1891), 3 Ch. 432.

[9] The Queen *v.* Sir Charles Reed (1880), 5 Q.B.D. 483; Baroness Wenlock *v.* River Dee Co., No. 1 (1885), L.R. 10 App. Cas. 359.

[10] *In re* Phœnix Bessemer Co. (1875), 44 L.J. Ch. 683; also *in re* Pyle Works, No. 1 (1890), 44 Ch. D. 534. The same was held by the Privy Council in another case. Newton *v.* The Debenture Holders of Anglo-Australian, etc., Co. (1895), A.C. 244.

[11] Howard *v.* Patent Ivory Co. (1888), 38 Ch. D. 156.

[12] Page *v.* International, etc., Trust (1893), 68 L.T. 435.

modes" or "in such other manner as the company determines"; [1] or to raise money on "any security of the company".[2] A power to charge the property is, however, not sufficient,[3] even if it was said that property both present and future may be charged.[4] That part of the capital which has been put into reserved liability cannot be charged, though the company was expressly empowered in its memorandum to charge its uncalled capital.[5]

The cases on special points are too numerous to be quoted *in extenso*. It is enough to state that in view of the difficulties which arise in connection with the interpretation and construction of objects clauses the aim of the framers of memoranda and articles has from early times been to give as wide powers as possible in order to secure to the company and its directors the possibility of working smoothly in any subsequent evolution of the company's business. This was especially important so long as an alteration of the objects clause was impossible. Even after such alteration was permitted the difficulties were not fully overcome, since beside a special resolution of the shareholders in general meeting the sanction of the Court was also required, and this in its turn was made dependent upon certain conditions being fulfilled. In most cases therefore the memoranda were framed with a wide definition of the purposes and a detailed enumeration of the ancillary objects.

The clauses in some cases do not reveal the real purpose of the company, and in many others include all fields of activity in which the company might possibly engage in future, so that the need to make alterations shall never arise. This was not the intention of the legislature. Table B of the First Schedule of the Act defined the objects of a steam packet company as follows: "The conveyance of passengers and goods in ships or boats between such places as the company may from time to time determine." Obviously it was the idea that the real purpose of the company should be clearly defined and that the assent of the shareholders in general meeting and the Court's sanction should be sought for any change.

In respect of ancillary objects Table B made a suggestion

[1] Jackson *v.* Rainford, etc., Co. (1896), 2 Ch. 340.
[2] Newton v. Debenture Holders, etc., Co. (1895), A.C. 244.
[3] Irvine *v.* Union Bank of Australia (1877), L.R. 2 App. Cas. 366.
[4] Streatham and General Estates Co. (1897), 1 Ch. 15, and *in re* Russian Spratts Ltd. (1898), 2 Ch. 149.
[5] Bartlett *v.* Mayfair Property Co. (1898), 2 Ch. 28, and *in re* Irish Club Co., Ltd., W.N. (1906), 127.

in a similar clear formula that the company shall be empowered to the "doing of all other things as are incidental or conducive to the attainment" of the object as defined. By the prevalent use of omnibus clauses this intention is frustrated. Such clauses enable a majority to change the whole character of the enterprise regardless of the minority; new purposes may be adopted and the original ones abandoned. Shareholders are in many cases not consulted beforehand. Whether in such a case the minority shareholders may demand the winding up for "just and equitable cause" under sec. 168 (6) (now sec. 222 (*f*) of the Act of 1948) is doubtful. Liquidations under this section were ordered in cases where the substratum of the company had gone; [1] but in another case [2] the Court allowed the petition for winding-up to stand over until the shareholders should consider a scheme in view of the wide powers of the Company under its memorandum.

It seems self-evident that the omnibus clause may constitute a grave danger. There is danger, however, in the opposite direction as well. It is possible, and occasionally actually happens, that, long as the list of ancillary objects in the memorandum may be, one or another is left out. The present position is therefore not satisfactory.

The legislation of South Africa (sec. 6, Fourth Schedule, Form A) and of New Zealand (sec. 14 (1) (*b*) and Table B) are identical with the British, as are the provisions of the Companies Acts of India and Palestine. Under the Companies Act of Canada the purposes of the proposed company are to be set out in the application for incorporation (sec. 5 (1) and Form I). Furthermore the Act carefully and exhaustively circumscribes the objects which are deemed to be ancillary to the purposes of the company and are therefore within its powers unless expressly excluded (sec. 14 (1)). The company is empowered "to do all such things are are incidental or conducive to the attainment of the objects of the company and the exercise of its powers". On the other hand a company carrying on any business not within the scope of the purposes or objects set forth in its letters patent or exercising or professing to exercise any powers not truly ancillary or reasonably incidental to its purposes or objects

[1] E.g. in *re* German Date Coffee Co. (1882), 20 Ch. D. 169, and *re* Haven Gold Mining Co. (1882), 20 Ch. D. 151; Red Rock Gold Mining Co. (1889), 61 L.T. 785, and *re* Blériot Aircraft Co. (1916), 32 T.L.R. 253.

[2] *In re* Stratton's Independence Ltd. (1916), 33 T.L.R. 98.

or such as are expressly excluded by its letters patent may be dissolved (sec. 5 (4)).

In the U.S.A. the doctrine adopted in England for chartered companies was never recognised, and corporations created by charter were always held to have authorisation only to carry on the business for which they were created.

With the adoption of general corporation laws, corporations became free to choose the objects and purposes for which they were formed. Nevertheless the old doctrine had some influence on the practice of the Courts, and corporation lawyers still follow the same course as in England. The objects of the corporation are defined in the widest possible terms, and the so-called implied powers are likewise defined in the greatest detail, stating what acts are to be regarded as ancillary and consequential to the expressly defined objects of the corporation. Consequently there is little scope for the application of rules evolved by the Courts on the question of implied powers and ancillary objects.

The view of the American is on the whole similar to that of the British Courts. There are, however, differences. Thus corporations are not regarded as having power to acquire shares in other corporations without express authorisation contained in the articles. Some other differences will be discussed in connection with the special points at issue.[1]

The legal consequences of contracts not within the ambit of the corporation's objects are discussed in § 65, Vol. II.

The position under European laws is determined by the doctrine adopted in respect of the powers of the management (see § 79, Vol. II). Here it is enough to mention that the validity of contracts cannot be questioned on the ground that it is outside the scope of the company. If the management goes beyond the purposes as set forth, this may or may not involve liability for damages; but the contract remains valid. Consequently the law is very broadminded in respect of the objects clause.

It is of course essential to include in the articles the objects of the company.[2] Likewise, companies cannot be formed for unlawful purposes. On the other hand the objects of companies may be outside of industry or commerce, and may even be non-economic. Furthermore the practice of the Courts allows very loose definitions. Thus in Germany companies were registered

[1] Cf. Ballantine, ss. 82–88.

[2] French law of 1867, Art. 1; German Law, § 16 (3), 2; Swiss O.R. 626, etc.

with the following clauses: Mercantile business of every kind; trade in commodities of every kind; manufacture of every kind of machinery. A clause extending the company's activity beyond its own specific purposes to other kinds of business is very frequently found. Thus the definitions "and the trade in other goods", "carrying on any other mercantile business", "participation in similar enterprises", and even "participation in other enterprises" (without further definition or qualification) have been registered.[1] The awkwardness of this practice was strongly criticised by Fischer in 1916; the tendency, however, was towards the greatest laxity, and this was even defended by Bing,[2] who states that out of 698 companies whose shares were listed on the Berlin Stock Exchange in 1928 no less than 189 had in their articles a clause allowing participation in other enterprises.

The question of ancillary and consequential objects does not arise at all in view of the provision commonly found in Continental legislations that, although the shareholders in general meeting may give instructions to the management to refrain from certain classes of business or from individual contracts, such instructions are inoperative as against third parties.

It is obvious that this state of the law was a strong factor facilitating the building up of huge combines, especially in Germany.

V. LIMITATION OF LIABILITY

Where limited liability is not an inevitable incident of a corporation, the constituent act must contain a clause stating whether the liability of the members is limited and, if so, whether by guarantee or by shares, i.e. is restricted to their contribution as defined by the par value of the shares and the premium, if any.

This is the case in Great Britain (sec. 1 (2)) and the countries of the British Commonwealth.

In the U.S.A. the common law rule is that the charter (certificate or articles of incorporation) may confer on the corporation the right to make assessments after the par value of the shares has been paid in full. No such assessment can be made unless authorised by the charter (certificate or articles of incorporation).

We have seen above that there are still corporations in respect of which a statutory liability is provided in some States, especially banking, insurance and mining companies. In this respect the

[1] Gadow, p. 49. [2] Düringer-Hachenburg, L. III, 1.286.

case of the National Banks is to be noted: until the recent Act double liability was established by Federal law, whereas now any State may dispense with it, and many States have availed themselves of this possibility. Apart from these exceptions the position in the U.S.A. depends entirely upon the constituent act, and the difference as compared with the British law is that whereas in Great Britain unlimited liability is the theoretical rule and an express provision in the memorandum is necessary for any limitation of liability, in the U.S.A. liability limited to the par value is the rule, and express provisions are needed to establish a right for the corporation to make assessments if the par value of the shares has been paid up in full.[1] In practice, however, limited liability is the rule for business corporations under both legal systems.

Alterations of the liability provided by the constituent act are possible by special resolution; but any increase of liability is operative only with the unanimous assent of all shareholders concerned. Reduction of liability, on the other hand, provided it does not affect the liability for the par value of the shares, does not require such assent, and a majority resolution is operative if it is in compliance with the prescribed formalities.

In Great Britain a company may be converted into one limited by guarantee or limited by shares and be registered as such, whereas likewise a company limited by guarantee may reduce the amount of the guarantee or convert itself into a company limited by shares. Such alterations, however, may never operate to the detriment of existing creditors (sec. 22).

Since the *Code de Commerce* (art. 33) Continental legislations have regarded limited liability as an essential attribute of a company, even to the extent that companies cannot by their articles impose any additional liability upon their members. Any provision imposing such liability is held void. For purposes which by their economic character and scope require a certain measure of liability exceeding the par value, these legislations have evolved special forms of corporate organisation, especially the co-operatives. There is of course no objection to the assumption of certain obligations for corporate debts, such as guarantee or suretyship. On the other hand, under all these legislations there are cases in which the members become liable on some special ground, e.g. for unlawful dividends or repayments.

[1] Anderson v. Abbott, 321 U.S. 349.

VI. THE CAPITAL CLAUSE

Under the Act of 1948 companies with a share capital must state in their memorandum the amount of that capital, the number of shares into which it is divided, and what part of it is represented by each share, i.e. the nominal (par) value (sec. 2 (4)).

The same is the rule in all countries of the British Commonwealth.

The legislations of the U.S.A. differ, apart from the obligation for the provision to be inserted into the charter (certificate or articles of incorporation), in so far as the issue of shares without par value is allowed in most of the States. The same applies to Canada.

If a company is to issue one or more classes of shares with preferential rights, this also is to be stated in the articles. Under English law the provisions as to preferential rights may be included in the memorandum, although this is not obligatory. If the memorandum contains such clauses, their alteration is somewhat more difficult. Holders of preference shares are protected against encroachments which they do not accept by majority resolution (see § 61, Vol. II).

In Canada the provisions as to several classes of shares must be inserted in the memorandum and also in the application. They are to be included in the letters patent (sec. 7 (1) (*g*), Form of Memorandum).

Under Continental legislations such provisions are to be included in the articles or, under Hungarian law, in the memorandum (150, 3). Alteration by majority resolution of the shareholders concerned is generally allowed for.

So far we have only discussed the issue of preference shares at the time of the company's formation. Earlier it was widely held that any subsequent issue of shares with preferential rights in connection with an increase of capital, or the grant of such rights in consideration of additional payments, is an impairment of the shareholders' rights which is not valid without unanimous assent. Nowadays, however, such a possibility is generally admitted (see § 61, Vol. II).

VII. THE ASSOCIATION CLAUSE

English law took from the earliest times the view that the decision to form a company must be declared in the constituent act, i.e. the deed of settlement and subsequently the memorandum.

The Act of 1948 in accordance with the earlier Company Acts prescribes an "association clause" as an inevitable part of the memorandum. Table B uses the wording: "We . . . are desirous of being formed into a company. . . ." The same technique is followed by the legislations of the British Commonwealth.

In the U.S.A. the terminology, dating from the period before general corporation laws were enacted, frequently follows the typical formula that the consent of the incorporators is necessary for the creation of a corporation and that without acceptance of the charter by the incorporators a corporation cannot come into existence. Such acceptance, however, is not made to depend upon any formality; it may be implied, e.g. by the exercise of corporate powers.[1] The general corporation laws on the other hand require the filing of an application for incorporation, called either the certificate or sometimes the articles of incorporation, which is to be signed by the incorporators, the signature and filing constituting and being conclusive evidence of the assent of the incorporators.

By European legislations the question is settled on the following lines:

For so-called simultaneous formation the German law requires the incorporators (*Gründer*) to sign the document in which the articles are laid down. It is to be drawn up in judicial or notarial form. Provided the whole capital is subscribed in the same or in another similar judicial or notarial document and the board of supervision is appointed by the incorporators, no meeting of the shareholders is necessary.[2]

The law requires for the registration an incorporator's report, a report from the board and from the management (§§ 24, 25). These reports, however, are of very small importance with regard to the matter discussed in this section; they will be discussed later in § 45.

Germany's example is followed by the Swiss law (638 O.R.). The French law does not specially mention this form of creation, but it is nevertheless held that a simultaneous formation is admissible (Pic 834). The document must be in notarial form. The Hungarian law requires in every case a general meeting,

[1] See e.g. Ballantine (1st ed.), s. 12.

[2] §§ 16 and 22 of law of 1937 in accordance with the law of 1884 and the Comm. Code, 1897.

called the constituent meeting, for which stricter rules are laid down than for subsequent meetings. Thus at least seven shareholders must attend either personally or by proxy; each share gives one vote, and no shareholder is to have more than ten votes (§ 155, 6), whereas for subsequent meetings all these matters are left to free regulation by the articles. The constituent meeting has to resolve upon the formation of the company; this is a special subject of its agenda (§ 154, 3).

VIII. SUBSCRIPTION

In Great Britain, as already stated, at least seven, or in the case of a private company two, shareholders must sign the memorandum and each take up at least one share. Each subscriber must write his address and description, and the number of the shares taken by him, opposite his name. There must be a witness to the signatures (sec. 3, Act of 1948), who must also give his address and description. There is no objection to one witness attesting all the signatures provided that he was present, and, as is obvious, a shareholder may not attest as witness the signatures of the other subscribers. The subscribers to the memorandum may be called the original subscribers, and each becomes by virtue of his subscription a member, i.e. a shareholder, of the company, with all the rights and duties inherent in the share or shares taken up by him.[1] As Lord Cairns stated in Evans' case: [2] "It is plain that the original subscribers are by the Act of Parliament deemed to have taken the shares set opposite to their names."

It is not necessary that the subscription should be accepted by the company after registration, or that an allotment of shares should be made.[3] Nor is the obligation to pay up the shares affected by the fact that the original subscriber was not entered in the register of members.[4]

The original subscription is held to be a declaration to the public. It cannot be repudiated for misrepresentation.[5] The same will presumably apply to mistake, although this question

[1] Migotti's case (1867), L.R. 4, Eq. 238.
[2] (1867), L.R. 2 Ch. App. 477.
[3] *Re* London and Provincial Consolidated Coal Co. (1877), 5 Ch. D. 525.
[4] Nicol's case (1885), 29 Ch. D. 421; Alexander *v.* Automatic Telephone Co. (1900), 2 Ch. 56.
[5] Metal Constituents Co. (1902), 1 Ch. 707.

has never been decided. On the other hand in Dunster's case,[1] the subscriber was not held liable since he intended to subscribe on behalf of his firm and the shares were in fact allotted to that firm. Similarly it was held in Evans' case, *ante*, and Mackley's case,[2] that if all the shares were allotted to others the subscriber will be regarded as discharged. Otherwise the subscriber cannot avoid his liability, even by acquiring fully paid shares from other shareholders. In one case,[3] an original shareholder was held liable although he was not entered in the register of shareholders throughout nine years after incorporation. These rules apply whether the subscriber took one share or more.

The cases in which one or another of the original subscriptions is invalid, e.g. in consequence of lack of capacity, or there are by oversight less than seven original subscribers, are considered in § 48.

In the U.S.A. there is generally no need of subscriptions to the stock (capital) before incorporation. Only a few States require subscription of a certain amount of capital as a condition precedent. The amount so required is generally small; in no State does it exceed $5000, and the fixed minima bear no relation to the authorised capital.

Under Continental legislation the position is reversed. The whole capital must be subscribed and a fixed minimum proportion is to be paid up before incorporation. This minimum is generally one-quarter of the par value; under Swiss law 20 per cent. (633 O.R.), in Hungary 30 per cent., with the proviso that at least 10 per cent. is to be paid simultaneously with subscription, which is otherwise inoperative.[4] The remaining 20 per cent. is to be paid before application for registration. In view of the inconvenience of two consecutive payments 30 per cent. is practically always required in the memoranda. A higher but not a lower minimum may be required by the articles.

The "authorised capital" of the German law of 1937 (§ 167) is in fact a power given to the management to increase the capital without a resolution of the shareholders in general meeting. This power may be granted in the articles for the first five years or a shorter time and at most for 50 per cent. of the capital.

For the original subscription the German, French and Swiss

[1] (1894), 3 Ch. 473.
[2] (1875), 1 Ch. D. 247.
[3] Esparto Trading Co. (1879), 12 Ch. D. 191.
[4] § 151, par. 2, 7.

laws require a public, i.e. a judicial or notarial document. This requirement is adopted by other legislations also. Hungarian law requires only subscription on a list attached to a copy of the memorandum signed by the incorporators (promoters). Neither the signature of the memorandum nor the subscription require legal or notarial form (§§ 150, 151). On the legal effect of the original subscriptions the view is generally identical with that held in Great Britain.

The questions connected with subscriptions attacked for defects were broadly discussed by German Courts. It is held that before registration of the company the subscription may be attacked like any contract, e.g. for fraud or mistake;[1] after registration, however, this is not admitted.[2] It was even held that a repudiation already declared ceases to be operative after registration.[3] A prominent commentator on the law of 1937 put forward the view that even lack of capacity could not be objected, and that after registration not only could the validity of the incorporation not be contested, but the subscriber would be bound regardless of his incapacity.[4] This is undoubtedly a gross exaggeration.

44. Issue and Placing of Shares

(A) THE PROSPECTUS

That part of the capital which was not taken up by the subscribers to the memorandum may be secured under British law from persons who wish to join the company. This may be done either by private agreement or by invitation to the public.

A private agreement to take shares in a company is subject to the same rules as any other contract. It requires no formalities.[5] In this respect there is no difference between an agreement to take shares and any other agreement.[6]

The agreement by itself, however, is not sufficient: in order to become a member the person concerned must have been entered in the Register of Members. "Every other person (i.e. other than a subscriber to the memorandum) who agrees to

[1] R.G.Z. 127, 191. [2] Constant view of the R.G.Z., thus in 142, 103 and 145, 158.
[3] R.G.Z. 82, 378. [4] Gadow, n. 4, s. 2. [5] Ritso's case (1877), 4 Ch. D. 774.
[6] Per Chitty, J., in Nicol's case (1885), 29 Ch.D. 421.

become a member of the company and whose name is entered in its register of members shall be a member of the company" (sec. 26 (2)).

Private agreements to take shares may be made orally or by telephone, telegram or letter. Frequently, however, they are made by application to the company and acceptance thereby. The application is subject to no more formality than the agreement itself. There is nothing to exclude the validity of an oral application.[1]

Under the law up to 1947 the application could be withdrawn so long as it had not been accepted by the company, and no notification of its acceptance had reached the applicant. If such notification is made by post, it is its posting which is decisive; until the posting of the letter of acceptance the withdrawal may be effected.[2] Withdrawal may also be oral.[3] If made by post it is operative only if it reaches the company before the letter of acceptance was posted.[4] If the letter of acceptance, i.e. the notification of the allotment, reaches the applicant after he has withdrawn his application he must repudiate it, otherwise he will be bound.[5]

This possibility of withdrawal impairs the basis of placings; it is specially inconvenient in cases where the company invites the general public to take shares. The reform introduced by the Companies Act 1947 will be discussed later.

Under English law an application may be conditional. If the condition is precedent and the acceptance was made in disregard of it there is no contract, and the applicant is entitled to repudiate the acceptance, i.e. the allotment of the shares for which he applied.[6] The applicant must, however, repudiate promptly after having received the notice, otherwise he will be regarded as having waived the condition.[7] If on the other hand the application was made under a condition subsequent, the agreement is valid and the applicant is bound by it, although

[1] Bloxam's case (1864), 33 Beav. 529, on appeal (1864), 4 de G. J. & S. 447; Levita's case (1867), L.R. 3 Ch. App. 36.

[2] Dunlop *v.* Higgins (1848), 1 H.L. Cas. 381; Hebb's case (1867), L.R. 4 Equ. 9; Henthorn *v.* Fraser (1892), 2 Ch. 27; Wallace's case (1900), 2 Ch. 671.

[3] Truman's case (1894), 3 Ch. 272.

[4] Byrne *v.* Van Tienhofen (1880), L.R. 5, C.P.D. 344.

[5] Crawley's case (1869), 4 Ch. App. 322; Boyle's case (1885), 54 L.J. Ch. 550.

[6] Wood's case (1858), 3 De G. & J. 85; Roger's and Harrison's case (1868), L.R. 3 Ch. App. 633; Wood's case (1873), L.R. 15 Equ. 236; Shaw's case (1876), 34 L.T. 715.

[7] Wheatcroft's case (1873), 42 L.J. 853.

he may enforce the condition. The same is true in the case of a collateral agreement.[1]

The acceptance of the application and the notification thereof is usually made by allotment of the shares in question. This is invariably done in cases in which the public has been invited to subscribe and a prospectus issued. Allotment is the appropriation of a certain number of shares to the applicant. It is not necessary for the shares to be identified, e.g. by numbers.

An allotment may be made only by a duly constituted board of directors,[2] but an irregular allotment may be rectified subsequently by a regular board.[3] The allottee, however, may deal with the irregular allotment as a valid one [4] and a director who has himself joined in an irregular allotment is estopped from alleging the irregularity.[5]

The allotment must be unconditional, otherwise it is not an acceptance but a new offer which the allottee may or may not accept.[6] The allotment of a smaller number of shares than were applied for is as a rule, however, not to be regarded as a new offer. It is usual in case of invitation by prospectus to insert a clause reserving the right of reduced allotment, but this is not necessary.

An allotment not followed by notification would not be sufficient. "Where an individual applies for shares in a company, there being no obligation to let him have any, there must be a response by the company, otherwise there is no contract", said Lord Cairns.[7]

Except in cases of invitation by issue of a prospectus no formalities are required for the notification. The position is the same as in respect of an application. The applicant may be informed orally.[8] The notification may be implicit, e.g. in a case in which the company demanded payment without an earlier express notification.[9] Where the application is actually

[1] Thomson's case (1865), 4 De G. J. and S. 749; Elkington's case (1867), L.R. 2 Ch. App. 511; Fisher's case; Sherrington's case (1885), 31 Ch. D. 120.

[2] *In re* Homer District Consolidated Gold Mines (1888), 39 Ch. D. 546.

[3] Portuguese Consolidated Copper Mines (1889), 42 Ch. D. 160.

[4] According to the rule in Royal British Bank *v.* Turquand (1856), 6 El. & Bl. 327; cf. Owen and Ashworth's claim (1901), 11 Ch. 115.

[5] York Tramways Co. *v.* Willows (1882), 8 Q.B.D. 685; Jackson *v.* Turquand (1867), L.R. 4 H.L. 305.

[6] Leeds Banking Co. (1865), L.R. 1 Equ. 225.

[7] Pellat's case (1867), L.R. 2 Ch. App. 527.

[8] Gunn's case (1867), L.R. 3 Ch. App. 40.

[9] Forget *v.* Cement Products of Canada, W.N. (1916), 259.

the answer to a specific offer by the company, e.g. pursuant to a scheme of reorganisation or amalgamation, there will be no need for notification,[1] but we must be careful to distinguish specific offers from circulars which in fact invite application.[2]

The notice is generally given by post. In such a case it is completed by the posting of the letter even if it is never received by the applicant.[3]

Allotment must be made and notice thereof given within a reasonable time. In case of unreasonable delay the applicant is entitled to repudiate the contract.[4] What time is reasonable depends on the circumstances. The onus as to the allotment and notice is on the company.[5] The subsequent conduct of the allottee may relieve the company of the burden of proof. Thus he is bound if it is shown that he had knowledge of the allotment though merely accidentally and not from the company,[6] or signed a blank transfer of the shares,[7] or was present at a board meeting at which the allotment was resolved on, though he did not receive notice of the ensuing allotment.[8]

It is to be remembered that even if allotment was duly made after the application and notice thereof communicated, membership is not acquired if there was no registration.[9] On the other hand an entry in the register of members does not create membership if there is no contract or the contract is invalid. One who is wrongfully entered on the register may request his removal, and the Court will not enforce the assessment even if the company is in liquidation in absence of a valid contract.[10]

If the allotment expressly referred to a condition laid down in the application but the entry was made in disregard of this condition, the entry may be avoided.[11]

If the company wrongfully refuses entry in the register of members the allottee has an action for damages, or he may sue for specific performance, which the Court may order or refuse

[1] Gunn's case (1867), L.R. 3 Ch. App. 40.
[2] Cf. Wallace's case (1900), 2 Ch. 671.
[3] Harris's case (1872), L.R. 7 Ch. App. 357.
[4] Ramsgate Victoria Hotel *v.* Montefiore (1866), L.R. Ex. Cas. 109; Crawley's case (1869), 4 Ch. App. 322.
[5] Reidpath's case (1870), L.R. 11 Equ. 86.
[6] Wallis's case (1868), L.R. 4 Ch. App. 325.
[7] Crawley's case, *supra*; *re* Richards and the Home Assurance Association (1861), L.R. 6 C.P. 591.
[8] Saloon Steam Packet Co. W.N. (1867), 259.
[9] Nicol's case (1885), 29 Ch. D. 421.
[10] Arnot's case (1887), 36 Ch. D. 702.
[11] Spitzel *v.* Chinese Corporation (1899), 80 L.T. 347.

at its discretion.[1] If, however, all the shares have already been allotted to other persons previous to the action, the only remedy would be an action for damages, since the company cannot be compelled to increase its capital in order to be able to perform the contract.[2]

English law thus regards the acquisition of shares from a company as a contract. This contract, like any other, may be invalid if the application was made without the intention of contracting.[3] In case of mistake as to the identity of the company the applicant may be entitled to repudiate membership, provided he acts promptly after having discovered his mistake.[4]

Lastly the application and the subsequent contract may be voidable for misrepresentation. This may consist in giving false information or in withholding information as to material facts, thus creating an erroneous impression. It is hardly conceivable that anyone would take shares in a company without asking for information. Generally the initiative comes from the company, from the directors or promoters, issuing houses or brokers, as the case may be, who wish to place the shares and who to that end give information about the company and its prospects. It is for the company and the persons acting on its behalf to decide what information they choose to give to prospective shareholders. They incur the risk of rescission should it subsequently be proved that the information was either incorrect or incomplete as to material facts.

If the shares are placed among friends, customers, or generally within a restricted circle, the question is governed by the general rules of the law of contracts. For cases, however, in which offer is made to the general public English law has evolved a special and elaborate regulation. The gradual evolution of this has already been discussed, and we are here concerned only with the law as it stood under the Act of 1929.

Offers of shares to the public have from early times been made by the issue of a prospectus, i.e. a written or printed invitation setting out the terms on which the shares may be taken and also giving information about the company and its prospects.

[1] New Brunswick, etc., Co. *v.* Muggeridge (1860), 1 Dr. & Sm. 363; Oriental Ireland Steam Co. *v.* Briggs (1861), 31 L.J. Ch. 241; Odessa Tramways Co. *v.* Mendel (1878), 8 Ch. D. 235.

[2] Ferguson *v.* Wilson (1866), L.R. 2 Ch. App. 77.

[3] Coventry's case, Britannia Fire Association (1891), 1 Ch. 202, C.A.

[4] International Society of Auctioneers and Valuers, Baillie's case (1898), 1 Ch. 110.

Under sec. 380 of the Act of 1929 any notice, circular, advertisement or other invitation offering shares to the public is deemed to be a prospectus and is governed by the same *rules*. It is immaterial whether it is issued before or after incorporation, originates from the company or is issued on its behalf. The rules apply also to invitations in respect of shares which were acquired previously in the course of a private placing and subsequently offered to the public. The same rules apply to issues of additional shares in connection with an increase of capital (see § 90, Vol. II, and also as to debentures § 60, Vol. II).

For the application of the rules governing prospectuses it is relevant whether they are addressed to the public. Invitations to a restricted number of relatives, friends or customers are not offers to the public.[1] A communication distributed in 3000 copies among the members of certain gas companies has been held to be a prospectus.[2]

A document deemed to be a prospectus must be delivered to the Registrar for registration on or before the date of its publication; no prospectus may be issued until a copy has been so delivered. In case of contravention every person knowingly a party to the issue of the prospectus is liable to a fine not exceeding £5 for every day of the delay.

The prospectus is to be dated, and to be signed by every person named therein as a director or proposed director, otherwise it cannot be registered; and every prospectus must state on the face that a copy has been delivered for registration (sec. 34). The Registrar may not register a prospectus which is not dated or is not signed by all persons who have to sign it.

The contents of the prospectus are prescribed (sec. 35 and Fourth Schedule), and any condition requiring or binding an applicant to waive compliance with any of the requirements or purporting to affect him with any contract, document or matter not specifically referred to in the prospectus is void (sec. 35 (2)). In cases where shares are issued for a consideration other than cash and where the proceeds of the issue are to be applied wholly or partly for the purchase of property certain special requirements apply, which will be considered in § 45.

Every prospectus, except when published merely as a newspaper

[1] Sleigh *v.* Glasgow and Transvaal Options (1904), 6 F. 420; Sherwell *v.* Combined Incandescent Mantles Syndicate (1907), 23 T.L.R. 482.

[2] South of England Natural Gas and Petroleum Co. (1911), 1 Ch. 573.

advertisement, must state the contents of the memorandum with particulars as to its signatories and the numbers of shares subscribed by each of them. The prospectus must further state: (1) particulars as to founders' or management or deferred shares, if any, and the interests of the holders thereof in the property and profits of the company; (2) the provisions of the articles in respect of the qualification and remuneration of the directors; (3) the names, description and addresses of directors and proposed directors; (4) the amount of preliminary expenses payable by the company and the commissions payable to any person in consideration of his agreeing to subscribe for shares of the company or his promising or agreeing to procure subscriptions, and further what part of these expenses is to be defrayed from the proceeds of the issue, and, where any money has been borrowed for the purpose of such repayment, if any part thereof is to be provided otherwise than by the proceeds of the issue and the amounts and the sources out of which that part is to be provided; (5) the minimum amount which in the opinion of the directors is required to cover the expenses mentioned and to provide for working capital, and where property has been or is to be purchased, the particulars relating thereto (sec. 43); (6) what amount is payable on application and what on allotment of each share—if it is a second or subsequent offer, particulars of the preceding issues, i.e. shares offered and allotted within the two years preceding and the amounts paid on these shares; (7) the amounts which in the preceding two years have been paid for subscribing or agreeing to subscribe or for procuring or agreeing to procure subscriptions of shares or debentures of the company and the rate of any such commission; (8) the amount or estimated amount of preliminary expenses; (9) the amount paid within the two preceding years or intended to be paid to any promoter and the consideration for any such payment; (10) in cases where material contracts outside the ordinary course of the business of the company have been made within two years previous to the issue of the prospectus, the dates and parties to them; (11) the names and addresses of the auditors of the company; (12) whether a director has any interest in the promotion of the company; (13) if there are different classes of shares, particulars as to the voting rights and the rights in respect of capital and dividends attached to each class; (14) if the company has been carrying on business for less than three

years, the length of time during which business has been carried on.

If the company has carried on business previous to the issue, reports by its auditors are to be set out in the prospectus showing the company's profits for the three years immediately preceding the issue together with particulars of the dividends paid; where different classes of shares exist, particulars as to each class and the dividends thereon, and where no dividends were paid on any class or all classes of shares, a statement to that effect; and if no accounts were made up in the period of three years ending three months before the issue, a statement of that fact. Material contracts defined under (10), Fourth Schedule, Part I, sec. 13, which are to be mentioned in the prospectus together with their dates and the parties thereto are to be placed in original or copy at the disposal of the public for inspection at a reasonable time and place.

The provisions in respect of the memorandum, the qualification, remuneration and interest of directors, the names, descriptions and addresses of directors or proposed directors and the amount or estimated amount of the premium and expenses do not apply in cases where the prospectus is issued more than two years after the date at which the company was entitled to commence business (Fourth Schedule, Part III, sec. 1). In such a case, however, the particulars of the previous issues and allotments are to be included (see (6); Fourth Schedule, Part I, sec. 7).

Together with the prospectus a form of application is to be issued, and it is unlawful to issue any other form of application under pain of a fine not exceeding £500. This provision does not apply to *bona fide* invitations to make an underwriting agreement in respect of the shares to be issued or, of course, to shares which are not offered to the public (sec. 35 (3)).

Formerly, the provisions as to prospectuses were sometimes evaded by a company's placing the shares by private agreement with a financial house on the understanding that the latter would subsequently offer them to the public. The financial house or houses engaged in such a transaction paid up the shares only after they had been offered to and taken by the public. The commissions realised by the financial houses were in some cases substantial and, although the placing of shares with financial houses was rather of a formal character, it was held that the company was in no way responsible for the prospectus issued

by the financial house in question. This position was altered by sec. 38 of the Act of 1929. Under subsection (1) of this section, where a company allots or agrees to allot any shares with a view to those shares or any part of them being offered to the public, any document by which the said offer is made shall be deemed to be a prospectus issued by the company, and this for all purposes, i.e. as to the information to be given, the application and liability. The company is liable to the subscribers in the same way and to the same extent as if it had itself issued the prospectus. The persons who issued the prospectus are in such a case responsible in their own person for its contents and omissions (subsec. (1)). It is further provided that beside the normal contents of the prospectus the net amount of the consideration received or to be received by the company in respect of the shares is to be stated. Furthermore the contract under which the shares have been or are to be allotted is to be open for inspection and the place and time at which it may be inspected are to be stated in the prospectus (subsec. (3)). These provisions are strengthened by a rule of evidence. If the offer for sale is issued within six months after the allotment or agreement to allot made by the company, or the company has not received the whole of the consideration for the shares, the allotment is presumed to have been made with a view to the shares being offered for sale to the public unless the contrary is proved (subsec. (2)).

In the prospectus and the attached form of application the time within which the application is to be made, i.e. the list for subscription is open, and that part of the par value which is to be paid must be stated. This time is usually very short. In many cases the lists are closed on the day of issue, and it has frequently happened that popular issues have been closed within an hour or even five minutes.

Since prospectuses were until recently issued on the same day on which the lists were opened, i.e. on which applications could be made, the prospective shareholders were hardly in a position to study the prospectus, and even less the material contracts or other documents which were open to inspection. They could not form an opinion of their own as to the merits of the investments proposed, but had to rely on the advice of their banker, who might or might not be in a position to give reliable information and counsel. Consequently in every period of increased

business activity, and especially during booms, many subscriptions were made without scrutiny.

Moreover, since the subscribers were not bound before allotment had been notified, a certain class of speculators, called in Stock Exchange slang "stags", made a regular business of subscribing, not with a view to investment, but to realising within a short time, a couple of days or even hours, and making a profit by selling the shares at a premium. The "stags" carefully watch the market and particularly how issues are progressing, and if they decide that things are not going well, withdraw their subscriptions. This gives rise to a certain factor of instability, against which companies and issuing financial houses seek protection. One protective method is maximum speed in allotment. But this is not always successful, and in the case of larger issues is hardly practicable. Companies or issuing houses therefore resort to the method of underwriting, i.e. the making of agreements with insurers to the effect that the latter shall take up such shares as are not subscribed by the public or in respect of which applications are made but are subsequently withdrawn. The underwriters of course demand a commission, the rate of which varies according to circumstances. These commissions operate to increase the preliminary expenses of the company; nevertheless the expense is a necessary one, and substantial issues can hardly if ever be made without the help of underwriters. The underwriters in their turn divide the risk among themselves, often recruiting sub-underwriters who are in relation with only one of them, and who bind themselves to take a certain quota of the shares which the underwriter would have to take up by virtue of his underwriting agreement.

The obligations imposed by the law as to the issue and contents of the prospectus place a heavy responsibility upon directors, and it is not surprising that after these obligations were introduced in 1900 attempts were made to evade them. The simplest way of doing this is to place the shares by private contract, postponing the invitation to the public till after the six months' period during which the provision of sec. 38 (2) as to evidence is operative. This has been countered since 1908 by the clause now contained in sec. 40 of the Act in its amended form that a company which has not issued a prospectus, or has issued one but has not proceeded to allotment, must at latest three days before the first allotment deliver a statement in lieu of prospectus to the Registrar

of Companies. This statement is to be signed by every person who is named therein as a director or proposed director. The contents of the statement are prescribed in Schedule 5; they are in all essentials identical with those prescribed for the prospectus. In case of contravention the company and every director who knowingly authorises or permits the contravention is liable to a fine not exceeding £100 (sec. 40).

In the case of an offer to the public for subscription no allotment may be made unless the minimum amount stated in the prospectus is covered by the subscriptions and the sum payable on application, which as already mentioned may not be less than 5 per cent., is in fact paid. The company is allowed forty days from the first issue of the prospectus to comply with these requirements; otherwise the moneys received must be repaid within a further eight days. After these forty-eight days have expired the company and its directors are jointly and severally liable for the amounts in question with 5 per cent. interest. Any condition to waive compliance imposed upon the applicants is void (sec. 39). These requirements, with the exception of the 5 per cent. minimum payment, do not apply to a second or subsequent allotment (sec. 39 (6)).

We must remember that all companies other than private companies have to comply with certain requirements before commencing business and exercising borrowing powers. When the company has issued a prospectus these conditions are as follows: that the minimum amount of subscriptions for cash as fixed in the prospectus is allotted, that each director has paid for the shares taken or to be taken by him the amounts which according to the prospectus are payable on application and allotment, and that there has been delivered to the Registrar of Companies a statutory declaration in the prescribed form, signed by the secretary or one of the directors, stating that these conditions have been complied with. For companies which have not issued a prospectus the conditions are that a statement in lieu of prospectus has been delivered, and that every director has paid on each share taken or contracted to be taken by him for cash a proportional amount equal to that to be paid by other applicants for shares for cash on application and allotment, and a statutory declaration in the form and with the signature as aforesaid to this effect.

If the company has complied with these conditions the Registrar

issues a certificate that it is entitled to commence business, and this certificate is conclusive evidence that the company is entitled to do so. So long as a company has not complied with the aforesaid conditions any contract made in the name of the company shall be provisional and not binding on the company until the issue of the certificate. Apart from this the commencement of business or exercise of borrowing powers before the issue of the certificate makes every person responsible for contravention liable to a fine not exceeding £50 for every day during which the contravention continues (sec. 94).

The duty of making returns of the allotments is imposed upon the company and its directors. The liability for the prospectus is discussed separately in § 46.

In the U.S.A. the practice is to begin with incorporation and not to take the steps necessary to procure the capital until the incorporation is completed. Where a minimum of capital is required as a condition precedent of incorporation, that minimum is to be procured by subscription and payment, and evidence thereof is to be submitted as required by the statute. Under the legislations providing for such a minimum it is nevertheless usual to procure only the minimum before incorporation.

There are even legislations which admit an intermediate step, "organisation" as it is called, that is, the adoption of by-laws and the election of the board. Where organisation is thus regarded as a separate step in the process of forming a corporation, the incorporators may—but are not bound to—organise the company before incorporation. If the incorporators choose to incorporate before organisation the question of the time of organisation arises. Under some legislations this is fixed by the constitution or the statute, and such provisions may be mandatory or merely directive. Where a time for organisation is not laid down, reasonable time for its completion is deemed to be required. The general rule is that the corporation must be organised within the State concerned, and in the case of a purely local corporation it may be necessary to perform the required acts within a particular locality.[1] The provisions of the general corporation law as to procedure are to be complied with.

The earlier charters usually provided for the appointment of commissioners with the duty of calling for subscriptions and convening a meeting of the subscribers to resolve upon the formal

[1] Fletcher 3742.

organisation. Similar provisions are still contained in some existing corporation laws. The commissioners have power to perform acts within their competence and also the duty to do all that is necessary for the organisation. Their authority is limited as to time and restricted to the act of organisation. They have therefore no power to carry on the business of the corporation or to do anything on its behalf or on behalf of its shareholders which is not included in the scope of organisation.

On the other hand their office and power terminates with the resolution of the shareholders adopting the by-laws and electing the directors. Their power is not as a rule revocable, but they may be removed by the Court if they fail to comply with the provisions governing their duties within a reasonable time.

Some corporation laws prescribe place, time and formalities of convocation for the first meeting. Such provisions are generally held to be merely directive, and if the meeting has been held and a sufficient number of subscribers were present and adopted the necessary resolutions, non-compliance with these provisions does not prevent the existence of a *de jure* corporation.

The commissioners are generally required to make a report of their proceedings and to file it in some public office, usually that of the Secretary of State. If the incorporators themselves have to effect the organisation, it is their duty to make and file the report.

In addition to this report many legislations require that a certificate of organisation be recorded by some public officer, such as the Recorder of Deeds. Such certificate of organisation may be an act without which the corporation is not deemed to have been organised, or merely an act of evidence. Again, some legislations regard it as conclusive evidence of the lawful completion of the organisation, whereas in others this evidence may be rebutted.

The subscription itself is generally regarded as a contract between the corporation and the stockholders. As a rule no formalities are required for this contract. It is usually made in writing by subscribing a list, but it may be made in any other form, or even orally. It is therefore important to ascertain whether the agreement is actually an agreement to take shares or merely one to subscribe shares in future.

In case of an agreement to take shares, acceptance of the

offer by the company makes the subscriber a member (shareholder) of the corporation, and pursuant to the assent of the corporation he is under obligation to pay the par value of the shares to the company. On the other hand an agreement to subscribe shares in future does not in itself imply acquisition of membership, and therefore in case of breach of the agreement the company as a rule may claim damages but not sue for specific performance. An agreement to take shares, or, as it is frequently called, a present subscription, is distinguished from a purchase of shares from the company out of treasury stock. This latter transaction is governed by the rules applying generally to contracts of sale and purchase of securities.

If the purchase was made before the company was incorporated it was formerly disputed whether the subscription was a valid offer at all, since the corporation was not yet existent. Nowadays it is generally recognised that the corporation may, after it comes into existence, accept the offer. In some States, however, e.g. Tennessee, it is held that the incorporation itself is sufficient to operate as completion of the contract. It is a majority rule in the U.S.A. that any subscription may be withdrawn until accepted by the corporation. But even this is disputed, and some Courts hold that if several individuals sign a subscription list or other paper it is an agreement as between the subscribers to take part in the corporation and that the subscription may not be withdrawn.

A further question is whether the corporation has an action, and if so whether for specific performance or only for damages, as was held, e.g. in Eden *v.* Miller.[1]

All the implications of the contractual nature of the subscription are accepted essentially in the same way as in Great Britain. But it is held that the subscription of the full amount of the capital fixed by the charter or articles of incorporation, or if only a certain part of the stock was put upon subscription, the subscription in full of that part, is a condition precedent of the liability of subscribers. It may be expressly stipulated otherwise, and a subscriber may of course waive this condition.[2]

American corporations formed from about the time of the Civil War have increasingly used prospectuses and publicity to raise the capital needed. Underwriting agreements also have

[1] 37 F. (2d.); 66 A. 2d. (1930). [2] Cf. Ballantine, ss. 189–97.

been and still are in use, especially in case of larger issues. Nevertheless American common law has not evolved special rules as to prospectuses, and the provisions of the corporation laws of the States are scanty. The Federal Securities Act of 1933, however, introduced detailed provisions in respect of prospectuses relating to shares and other securities.

As we saw in § 22, this Act applies to securities distributed by mail or other means of inter-State communication.

We have also seen that all corporations concerned have to file a registration statement with the Securities and Exchange Commission. Sec. 6 (Schedule A) of the Act prescribes in detail the information which is to be submitted to the Commission. The requirements of the Act, as we have seen, go very far, though the Commission is empowered to grant exemptions. Omitting those particulars whose disclosure is likewise required under the law of Great Britain, it is to be noted that the holdings of directors, executives and underwriters are to be stated as well as every holding exceeding 10 per cent. of any class of shares, the remunerations to be paid to any of the directors and persons performing similar functions, and generally every remuneration exceeding $25,000 per year, and all commissions or discounts to be paid to underwriters. The general effect of material contracts is to be included in the statement, and Counsel's opinion on the legality of the contract is to be produced.

It is provided that no security may be carried through the mails or in inter-State commerce for the purpose of sale or delivery after sale unless accompanied by a prospectus complying with the requirements of the Act (sec. 5 (*b*) (II)). Every prospectus, notice, circular, advertisement, letter or communication written or by radio is deemed to be a prospectus and is to be filed with the Commission. Communications based on a previous prospectus are excepted if the prospectus was sent to the addressee or a statement where the prospectus may be obtained is included, and the communication does not state more than the identity of the security, its price, and the person by whom orders will be executed (sec. 2 (10)).

The prospectus is to contain the same information as is required in respect of a registration statement, with the exception that copies of the agreements with underwriters, of counsel's opinion on the legality of the issue, copies of material contracts and of the articles need not be attached. The Commission may

grant exemptions, and may on the other hand ask for additional information (sec. 10 and Schedule B) if it finds it proper or necessary in the public interest to do so.

In view of the strict provisions of the Act and especially of the rules as to evidence, corporations and issuers are inclined to include every item which has to be included in the registration statement and to include or attach all contracts which may be regarded as material. Condensation of such contracts is not unreasonably considered dangerous, since any omission might subsequently be argued to be intentional concealment.

The prospectuses published since the passing of the Act of 1933 are extremely bulky. Their preparation, printing and circulation involves considerable and sometimes superfluous expense. On the other hand experience shows that the longer and bulkier a prospectus, the less informative it is to the average investor, since he cannot afford the time and has not the knowledge necessary to acquaint himself with the matter and to form an independent judgment. Even an expert finds his way through the documents only by an intensive study. Consequently the excessive elaboration of the requirements seems to be of dubious value.

German law, as we saw above, for cases in which any part of the capital was not placed among the *Gründer*, i.e. not all the shares were taken by them by execution of one or several documents (see § 41) evolved a special procedure, "successive formation" (*Successivgründung*), now called *Stufengründung*. The first legislative regulation of this form was made in 1884, and it was maintained in 1897. The Drafts of 1930 and 1931 dispensed with it in view of the fact that in practice use was hardly, if ever, made of this cumbersome procedure of promotion. The law of 1937, however, included the provisions on *Stufengründung* with some minor amendments.

The main points are that in cases in which the founders (*Gründer*) do not take up all the shares they must raise the remainder of the capital by procuring subscriptions, i.e. declarations in writing showing the number of shares taken and their value, and where several classes of shares exist the respective class also. Oral declarations are not sufficient. The subscriptions are to be made on lists and to be executed in two copies. They have to contain: the date on which the articles were determined on, the capital of the company, the advantages and privileges

stipulated in favour of individual shareholders, what amounts are to be paid to shareholders or others as compensation or remuneration for their part in the promotion, the names, description and addresses of the *Gründer*, the issue price of the shares and the amount of the instalments to be paid, and the term for the resolution to form the company after the lapse of which the subscription will become inoperative. Conditional subscriptions are void; only one condition subsequent is admitted, the time-limit as aforesaid.

After the whole capital of the company has been subscribed the *Gründer* must convoke a meeting at which the first board of supervision is to be elected. The board must immediately appoint the management, i.e. one manager or more as provided in the articles. Subsequently the application for registration is to be submitted to the Court, with one copy of the subscription list attached, together with a cumulative list showing the number of shares taken by each shareholder (whether subscriber or *Gründer*) and the sums paid by each. On receipt of the application the Court calls a meeting of the subscribers (§ 30). Previous to this meeting the *Gründer* must draw up their report and submit it to the board of management for examination.

The report of the *Gründer* must state whether and to what extent shares were taken by nominees on behalf of members of the board or of the management, and whether the members of the board and management have stipulated for special advantages, compensation or remuneration for their activity in connection with the promotion. The special rules for the issue of shares for property are considered in § 45.

This report is to be examined by the board of supervision and the management. Moreover, if one of the members of the board or of the managers is a *Gründer*, or shares were taken up for one of these by a third party, or any of them stipulated for any special advantage, compensation or remuneration for their part in the promotion, and similarly in the case of the issue of shares for property (see § 45), the process of promotion is to be examined by auditors appointed by the Court (§ 25). This examination has particularly to ascertain the correctness of the statements contained in the documents.

The Court, having received the application for registration, calls a meeting which is presided over by one of its judges. The members of the board and of the management must report on

their examination of the promotion, and the meeting must then resolve whether the company is to be formed or not. The resolution is valid only if at least one-quarter of the subscribers holding at least one-quarter of the whole capital having a simple majority at the meeting vote in favour of the company's formation. Persons who receive special advantages, compensation or remuneration are excluded from voting, as are those who receive shares for property or from whom property is to be acquired.

In view of these provisions it is hardly surprising that promoters did not make more use of this cumbrous machinery after the law of 1937 than before, and that in actual fact companies, even those needing large capital, were formed by way of simultaneous promotion, i.e. by subscription of the whole capital and proportionate payment thereof. In many cases this was done with the help of banks or bankers, or groups of such, organised as a syndicate for the purpose of taking a substantial part of the capital and offering the shares to the public at a premium.

It was usual to make such offers by means of a prospectus. Such prospectuses, however, were regarded as offers for purchase falling under the rules of sale and purchase contracts, which were governed in Germany by the provisions of the Civil Code (B.G.B.) on contracts for the sale of goods with certain supplementary provisions of the Commercial Code. Special provisions exist only in respect of introductions of securities to the Stock Exchange.

It is to be remembered that subscriptions are regarded as being not contractual acts but acts of corporate law, or if as contracts at all, then at least as declarations whose effect is governed by their character as directed to the public, so that defects cannot be asserted as against the company.

The Swiss law (O.R.) similarly allows successive formation, i.e. the raising of capital by successive subscriptions. The *Gründer* have to draw up the articles and sign the draft before subscription begins. A report on the promotion is necessary only if it is proposed to grant special advantages to the *Gründer* or other persons, apart from cases where shares are issued for property or where property is to be taken over by the company. In this report not only the nature and destination of the special advantages but also the ground for the grants and the reasonableness of the advantages is to be shown (629).

The subscription is to be in writing; reference is to be made

to the draft of the articles, the price of the shares is to be stated, and also the time-limit after which the subscription becomes inoperative should the formation of the company not be by then completed.

If the shares are offered to the public a prospectus is to be issued, signed by the *Gründer*. This prospectus is to contain the articles with the prescribed minimum of provisions, special advantages if any, the essence of the report on the promotion, the time limit after which the subscription becomes inoperative, the place or places where subscriptions are accepted, the price of subscription, the proportion which is to be paid on the shares before the meeting, which cannot be less than 20 per cent., and the place or places where such payments can be made.

No prospectus, however, is required if the aforesaid statements are inserted on the forms on which subscriptions are to be made (631).

After the whole capital has been subscribed the *Gründer* are to call a general meeting of which at least ten days' previous notice is to be given to the subscribers in the way prescribed in the draft of the articles (634). The subscribers must ascertain at the meeting that the whole capital has been subscribed and the prescribed percentage paid. The meeting has to discuss the draft of the articles; this draft may be accepted or rejected, but essential alteration may be resolved upon only by a unanimous vote of the subscribers present or represented by proxy (635). The meeting has further to appoint the board and the supervising body (635). Special advantages may be granted only by a vote of at least two-thirds of the whole capital (636). The minutes of the meeting must be drawn up in a public, i.e. judicial or notarial document.

In respect of those legislations which do not distinguish between simultaneous and successive promotions there is nothing to add to § 41.

(B) AMENDMENTS OF THE COMPANIES ACT 1947

The 1947 Act contains a number of amendments, some substantial, some technical, but all aimed at giving better protection to the investing public. These amendments generally strengthen the requirements as to prospectuses contained in sec. 35 and the

Fourth Schedule of the Act of 1929. There are, however, relaxations in two directions.

It is provided (sec. 64 (1)) that if an offer is made of shares or debentures in all respects uniform with the shares and debentures already issued by the company, if they are dealt with or quoted on a prescribed Stock Exchange, sec. 35 shall not apply to the issue of a prospectus or the form of application. Furthermore, if in respect of shares or debentures application is made to any of the prescribed Stock Exchanges for permission to deal or be quoted on that Stock Exchange, a certificate of exemption from the requirements of the Fourth Schedule may on request be given by or on behalf of the Stock Exchange concerned. Such certificate shall be given where, having regard to the proposals as to the size and other circumstances of the issue and as to limitations on the number and class of the persons to whom the offer is to be made, compliance with the said requirements would be unduly burdensome. The effect of this certificate is that instead of satisfying the requirements of the Fourth Schedule the applicant has to comply with the conditions as to the particulars and their publication laid down by the Stock Exchange in connection with the permission. The provisions of the Act relating to applications and allotments, to be presently discussed, are not to apply in such a case. On the other hand the prospectus is to be registered in the same way as if it were issued in accordance with sec. 35 and the Fourth Schedule, with the qualification that the provisions relating to registration and inspection of a copy or memorandum of any contract shall apply to any contract which is required to be available for inspection in connection with the application made to the Stock Exchange for permission to deal (sec. 64 (2)–(4)).

The Act also defines what invitations are to be regarded as offers to the public. By sec. 68 (1) an offer made to any section of the public, whether selected as members or debenture holders of the company or as clients of the person issuing the prospectus or in any other manner, shall be regarded as an offer to the public.

The case when an invitation or offer is not to be regarded as a public offer is limited strictly to instances which "can properly be regarded in all the circumstances as not being calculated to result directly or indirectly in the shares or debentures becoming available for subscription or purchase by persons other than those

receiving the offer or invitation or otherwise as being a domestic concern of the persons making and receiving the offer".

Where a provision in the articles prohibits invitations to the public for subscriptions, offers made to members or debenture holders are not deemed to violate the prohibition. The same construction is to apply to the provisions of the 1929 Act relating to private companies (sec. 68 (2)).

There are amendments in respect of the statements to be made in prospectuses.

It is not necessary in future to include the contents of the company's memorandum and the particulars relating thereto in the prospectus. It must, however, beside the particulars already required, contain: (*a*) the time of opening of the subscription list; (*b*) particulars of any option in respect of shares or debentures of the company both as to their amounts and description, and the conditions of the option; (*c*) short particulars of any transactions completed during the preceding two years in respect of any property purchased or to be purchased or acquired by the company in which a director, proposed director, or promoter of the company had any interest direct or indirect; contracts in the ordinary course of business not made in contemplation of the issue, or the issue in consequence of the contract, are exempted, as also are contracts where the purchase money is immaterial; (*d*) besides the preliminary expenses the expenses of the issue are to be specified, and to what persons they are paid or payable; (*e*) besides the amounts paid within the last two years to any promoter, any benefit given during that period or intended to be given to any promoter and the consideration for any such benefit; (*f*) the general nature of all material contracts completed within the two preceding years (sec. 61).

There is no requirement to state in the prospectus a reasonable time and place where the material contracts may be inspected (sec. 61 (1)); on the other hand a copy of every contract and a memorandum in respect of every contract not reduced to writing is to be endorsed or attached to the prospectus when it is delivered for registration (sec. 63 (2) (*b*)). The inspection of these documents at the registrar's and the demand for extracts and copies of them is limited to fourteen days beginning with the date of publication of the prospectus. Thereafter the permission of the Board of Trade is necessary (sec. 63 (6)). Although it may well be that in most cases these documents will not be

inspected by many persons, these limitations on publicity are in our view not justified.

Disclosure of the interests of directors and promoters in any property purchased, acquired or to be purchased or acquired is obligatory, even if the prospectus was issued more than two years after the company became entitled to commence business (sec. 64 (4)).

The financial results of the company and of any business proposed to be purchased are in future to be given for five years instead of three.

The report of the company's auditors and accountants is to relate to the assets and liabilities, and also to profits and dividends up to the last date to which the accounts of the company or of the business to be purchased were made up (sec. 62 (1), (2)).

Special rules apply where the company has subsidiaries or intends out of the proceeds of the issue to acquire shares in another company. These cases will be considered in § 92, Vol. II.

If in the opinion of the person making the report adjustments should be made in the figures of assets and liabilities, or of profit and loss, he shall either indicate this by way of a note or make such adjustments and indicate them in the report (sec. 62 (7)).

If any statement by an expert is included in the prospectus, it shall not be issued unless the expert has given and not withdrawn his written consent. A statement of this fact is to appear in the prospectus. In case of contravention a fine not exceeding £500 may be imposed upon the company and on every person who is knowingly a party to the issue.

The declarations of consent are to be endorsed on or attached to the copy of the prospectus which is delivered for registration in the same way as the copy of any material contract or memorandum of any contract not reduced to writing, and the statement which is to appear on the face of the prospectus to the effect that a copy has been delivered to the Registrar must specify the statements and documents in question. Without such statement the prospectus cannot be registered, and failure to comply with this requirement is punishable with a fine similar to that imposed for failure to deliver the prospectus for registration (sec. 6). The provisions relating to statements in lieu of a prospectus are amended accordingly (sec. 67).

As to applications and allotments the Act accepts the recommendations of the Committee in respect both of a time limit

between the issue of the prospectus and the opening of the lists and of the irrevocability of applications.

It is provided (sec. 59) that both in case of a prospectus for subscription and of an offer for sale in respect of shares or debentures to persons who are not existing members or debenture holders of the company the lists shall not be opened before the beginning of the third day after the first issue of the prospectus—Sundays, Bank Holidays and Saturdays being disregarded. Advertisement of the prospectus in a newspaper is to be regarded as its first issue, but if no such notice is published before the third day after the first issue, the manner of issue is disregarded. Before the beginning of the said third day, called "the time of the opening of the subscription lists", no allotments shall be made and no proceedings shall be taken with respect to applications. If this requirement be not complied with the validity of the allotment is not affected, but the company and every officer who is in default, and similarly every person by and through whom the offer was made and who knowingly and wilfully authorises or permits the contravention, is to be liable to a fine not exceeding £500.

Applications for shares and debentures shall not be revocable before the expiration of the third day after the opening of the subscription lists—Saturdays, Sundays and Bank Holidays being disregarded. The company has therefore three days to close the lists and make the allotments.

Special rules apply if a prospectus, whether issued generally or not, refers to an application for permission to deal on any Stock Exchange, whether made or intended. Cases have occurred where subscribers applied for shares or debentures on the faith of such a communication and expected to receive securities marketable on the Stock Exchange. They had as a rule no means of recovering their loss, because the company or the financial house did not allege that permission to deal in the security offered for subscription or sale would actually be obtained. In view of the complaints voiced the Act provides that where a statement is made to the effect that an application has been or will be made for permission to deal on any Stock Exchange, allotments or applications in pursuance of the prospectus or the offer for sale shall be void if: (*a*) such application was in fact not made before the third day after the issue of the prospectus, or (*b*) permission was refused before the expiration of three weeks

from the closing of the lists, which may be extended to a period not exceeding six weeks if the applicant, i.e. the company or the issuing house, should be so notified by or on behalf of the Stock Exchange (sec. 60 (1)).

By subsec. (7) this permission shall not be deemed to have been refused if it is intended that the application, though not granted for the time being, shall be given further consideration. It is sufficient if the final decision be given within six weeks. Cases in which the refusal is made after six weeks have expired do not, however, appear to be covered by this provision, and strictly speaking the subscribers are then left without remedy, which is not at all satisfactory. It may be that such cases will be quite exceptional.

If the allotment becomes void, the company shall within eight days repay without interest all moneys received. Should it fail to do so, the directors are jointly and severally liable for the money received on such applications with 5 per cent. interest from the expiration of the eighth day, with the exception of directors who prove that the default was not due to any misconduct or negligence on their part.

In the case of an offer for sale the same obligation and liability is imposed upon any person by or through whom the offer was made and who knowingly and wilfully authorised or permitted the default. The protection provided in favour of shareholders is extended to underwriters (sec. 60 (8)).

The position of subscribers is safeguarded by the duty imposed on the company to keep all moneys received with applications in a separate bank account as long as the company may become liable for repayment, under penalty of a fine not exceeding £500.

Furthermore, a company which issues a prospectus containing a statement as to an application for dealing on a Stock Exchange before it has commenced business, is prohibited from so doing until its liability for repayment has ended. The statutory declaration required by sec. 94 of the 1929 Act is to include a statement making it clear that the company is not and cannot become liable under this heading.

All these provisions are intended to be compulsory: any condition requiring or binding any applicant for shares and debentures to waive compliance with any of the aforementioned requirements is declared void (sec. 58 (4)).[1]

[1] These provisions are incorporated in secs. 37–46 of the Act of 1948.

(C) ISSUE OF SHARES BELOW PAR

The statement of a share's par value does not mean that its effective value, i.e. the fraction of the company's net assets which it represents, is equal to the sum stated in the articles or share certificate. If "par value" has any meaning at all, it is that, when the share was issued for cash, the corresponding amount was paid in full, or, if only a part was actually paid, at least that the subscriber and any subsequent holder of the share is under obligation to pay the remainder to the company and is liable to the creditors for such payment.

Nevertheless in the evolution of corporation finance there have always been tendencies to evade this liability. Here we deal only with an original issue of shares for cash. The question of the issue of additional shares in connection with an increase of capital will be considered in § 90, Vol. II, and the struggle against the issue of shares for over-valued property in § 45.

From the principle that shares for cash shall not be issued below par, in other words unless each share is covered by an actual part payment and the creation of a debt on the part of the shareholder for the remainder, it follows that so-called bonus shares, i.e. shares issued without payment, are prohibited and that agreements with a shareholder to pay less than the par value of his shares are void. Sometimes, however, these rules are qualified.

In Great Britain the issue of bonus shares by a company is *ultra vires*.[1] In connection with increases of capital additional shares are sometimes distributed among the shareholders; but in such a case their par value is to be transferred from free reserves (see § 90, Vol. II).

The issue of shares at a discount, i.e. for less than their par value, has generally been held inadmissible, and an agreement between the company and any shareholder to this effect inoperative. This applied also to the liability as against creditors, so that the shareholder concerned was liable for their full value, whether the restrictive agreement was inserted in the memorandum or the articles [2] or was a separate document. In Welton *v.* Saffery [3] the House of Lords held that a provision of the articles to this effect was also inoperative as between the shareholders *inter se*.

[1] *In re* Eddystone Marine Insurance Co. (1893), 3 Ch. 9.
[2] Ooregum Gold Mining Co. of India *v.* Roper (1892), A.C. 125.
[3] (1897), A.C. 299.

A frequent method of evading the rule was for companies to agree to pay commissions for securing subscriptions, and the Acts of 1900 and 1908 legalised this within certain limits. The position is now regulated by sec. 53 of the Act of 1948, under which a commission not exceeding 10 per cent. of the issue price of the shares in question may be paid to any person in consideration of his subscribing or agreeing to subscribe, procuring or agreeing to procure subscriptions whether absolute or conditional. It has been, and still is, held [1] that in order to make the stipulation valid the subscriber must render some service to the company, and a commission cannot be granted to a subscriber who does nothing beyond subscribing.

The payment of such a commission is lawful if it is authorised in the articles, which may provide for less but not more than 10 per cent. The number of shares which persons have agreed for a commission to subscribe absolutely and the rate of commission are to be disclosed in the prospectus or the statement in lieu thereof, or in a special statement in prescribed form; or lastly in the circular or notice inviting a restricted circle of persons to subscribe. Failure to disclose makes the company and every officer in default liable to a fine not exceeding £25. The payment of the customary brokerage is not affected by these provisions (sec. 53 (3)).

The issue of additional shares in connection with an increase of capital is allowed at a discount (sec. 57) on certain conditions if sanctioned by the Court (see § 90, Vol. II).

In the U.S.A. a tendency to inflate capital was rather marked, and promoters found that to place shares with a higher par value at a discount was usually considerably easier than to place a fully paid share of a proportionately lower nominal value. In most cases resort was had to the issue of shares for a consideration in property at overvaluated prices; but there were cases in which shares, mostly ordinary shares, were issued at a considerable discount.

Certain corporation laws provide expressly for full payment of shares issued for cash. The typical provision, however, is that no shares may be issued except for money, property or services. Where the law expressly requires full payment, an agreement that a shareholder shall not be bound to pay in full is inoperative, whether made by the grant of a discount, a commission or otherwise.

[1] Keatinge *v.* Paringa Consolidated Mines Ltd., W.N. (1902), 15.

Where either the constitution or the corporation law forbids the issue of fictitious stock, that is, of shares without any consideration, or bonus shares as they are called, such shares are regarded as void, whereas the position of shares issued at a discount is disputed. On the other hand some Courts, as under the earlier law in New York, base the liability entirely on the terms of the subscription as a contract, and consequently hold that an issue at a discount not only binds the company as against the shareholder and gives the latter an effective defence against calls but is also valid as against creditors.[1] Usually, however, it is held that if the company becomes insolvent the subscribers of shares at a discount are liable to the creditors up to the full unpaid part of the nominal value of their shares. Story, J., based this rule upon the doctrine that the capital stock is a trust fund for the debts of the corporation.[2] From a theoretical viewpoint this doctrine is not without defects, because a fiduciary relation between the company and its members on the one side and the creditors on the other cannot be assumed; but it was nevertheless maintained for a long time, the capital being held to be a fund set apart for the payment of the debts of the corporation and as a substitute for personal liability. Even the Supreme Court adopted this doctrine many times, especially in the Upton cases.[3]

A consistent application of the doctrine would be that the shareholder is liable for the full remainder of the unpaid balance regardless of any agreement or release given by the company, whether the debt was created before or after the agreement, or whether the creditor had knowledge of the agreement or not. This construction has in fact been adopted in some cases;[4] in others the Courts have held that a creditor who at the time of granting the credit had knowledge of the agreement has no remedy. This view is based on the so-called "holding out" doctrine: by fixing its capital the company and the subscribers cause the public to believe that the shareholders are in fact obliged to put up the nominal capital and the full par value of the shares respectively, and the public as prospective creditors may rely upon this representation, having no means of obtaining knowledge of any agreements to the contrary. If, however, a shareholder

[1] Christensen *v.* Eno, 106 N.Y. 97.

[2] Wood *v.* Dummer (1824), 3 Mas. 308 Fed. Cas. 17944.

[3] Upton *v.* Tribilcock, 91 U.S. 45; Sanger *v.* Upton, 91 U.S. 56; Hatch *v.* Dana, 101 U.S. 205.

[4] Eastern National Bank *v.* American Brick and Tile Co. (1906), 70 N.J. Eq. 732.

can prove that the creditor had notice that the shares were issued at a discount, he cannot be compelled to pay. The same solution is accepted by those who base the liability upon the doctrine of fraud: there is no fraud where the creditor gave the credit with notice of the discount secured either by law or by a special agreement.[1]

As to the relation between the corporation and its stockholders the agreement is valid and binding and the corporation has no action against the stockholder. The Supreme Court has held [2] that in the absence of any express constitutional or statutory rule an agreement by which shareholders had to pay a part only of the par value was "as between them and the company . . . a perfectly valid agreement. It was not forbidden by the charter of the Company or by any law or public policy and as between the Company and its shareholders was just as binding as if it had been expressly authorised by the charter", "and consequently if the Corporation had made any call upon the shareholders for its own business purposes no suit could have been maintained by the Company to collect the unpaid stock for such purpose".

In Handley *v.* Stutz,[3] the Supreme Court held that if in the course of an increase of capital with the purpose of maintaining the company as a going concern shares were issued at a discount, even the creditors have no action against those who acquired the shares under agreements excluding liability for the unpaid part of the par value.[4]

The principle under European legislations is that an issue below par is prohibited and agreements to the contrary are void. Thus the German law (§ 9 (1)) expressly provides that shares may not be issued at a price below par. A similar provision was inserted into the Commercial Code by the law of 1884, and was maintained by § 184 of the Commercial Code of 1897. Discounts, commissions and other compensation may not be paid or granted to subscribers in consideration for the subscription. Any commissions or compensations paid for services of whatever kind in connection with the formation of the company are to be disclosed, and their aggregate amount is to be stated in the articles, otherwise they are not chargeable against the company (§ 19).

[1] Hospes *v.* North-Western Mfg. and Car Co. (1892), 48 Minn. 174.
[2] Scoville *v.* Thayer (1881), 105 U.S. 143. [3] (1891), 139 U.S. 417.
[4] Cf. Ballantine, s. 100; Berle and Magill, ch. 3; Dodd and Baker, ch. vii, sec. 4.

The Swiss O.R. likewise prohibits the issue of shares below par (624, par. 1). The expenses of promotion including any commissions are to be disclosed in the profit and loss account. On the other hand, in order that the company may be able to write off such expenses over a five-year period, the relevant agreement must be included in the articles or contained in a resolution of the general meeting (664).

45. Shares for Property

Companies have been formed at all times not only in order to start new enterprises but to take over existing businesses. This is sometimes done by the former owner or owners transferring the business unit to the new company as a going concern in consideration of the whole or a certain part of the capital, the remaining shares being issued for cash in order to procure working capital. In other cases all the shares are issued for cash and all or part of the proceeds of the issue applied to acquiring the existing business. Even when companies intend to form new business units, they often acquire the land and buildings necessary by issuing shares to the owners. This course gives promoters ample opportunity of realising large profits by stipulating for the issue to themselves of blocks of shares whose par value considerably exceeds the market value of the assets transferred, or by selling these assets to the company at inflated prices. The companies concerned are consequently under a serious handicap from the start; they are over-capitalised; their stock, in the slang phrase, is "watered".

This drawback might be and was in certain cases overcome in the event by favourable trading results, provided that the profits were applied to writing off the deficiency and adjusting the capital—that is, to pumping out the water. In other cases this was impossible, or the profits were distributed recklessly, and there was nothing left for a rainy day. Many companies have gone bankrupt or have had to be wound up or reorganised not because of current losses but owing to the initial disease of over-capitalisation.

The history of railways, particularly in the U.S.A., presents a vivid picture of this evil. The promoters of the companies secured contracts for themselves by which they undertook to construct the line, and to provide it with equipment at exorbitant

prices fixed in advance without regard to the actual costs, these prices being payable in cash if the company could raise the money by its shares and debentures, but more often in securities of the company allotted as consideration for building the line and its accessories. Abuse of stock-watering was rampant, especially where a company had several classes of securities with varying priorities. In such cases the real value of the assets sometimes covered only the bonds and possibly the preference shares, the ordinary shares being practically worthless and mere drafts on a brighter future which often failed to materialise. The promoters were careful to lay hands on all the money available and took the remainder as far as possible in so-called senior securities, i.e. bonds and preference shares which they could sell to the gullible public at a profit. Many cases of such promotions and financing are on record, especially that of the Credit Mobilier (see § 16).

These abuses led to the Courts evolving certain rulings establishing liability for watered stock, and the drawbacks of this method of financing soon became well known. Nevertheless in the era of consolidations and mergers over-capitalisation again became widespread.

A more lenient view was put forward, especially in the U.S.A., on the ground that what is decisive is after all not the actual market value of the tangible assets but the earning capacity of the business to be acquired, and therefore a certain excess degree of capitalisation, especially in the case of large consolidations, might be justified. It was contended that not only the tangible assets, but also the patents, trade-marks, business connections and everything included under the heading of goodwill represent effective values, and that therefore their vendors are entitled to receive compensation in the form of shares. Actually, however, apart from consideration to vendors large quantities of stock were issued to promoters and bankers to cover their expenses, fees and commissions. An official investigation [1] showed that in 183 industrial combines created with a total capital of $3,085,200,868, bonds amounted to $216,412,759, preference shares to $1,066,525,963 and common (ordinary) shares to $1,802,262,146 nominal value. The value of the assets was estimated at $1,458,522,563, i.e. only 47·3 per cent. of the capitalisation. True, the value of means of communication and of prairie and forest property was not

[1] *U.S. Industrial Committee Report*, I. 1022 (1900), and *Final Report*, XIX. 617 (1902).

included. But even if these are taken into account it is obvious that the ordinary shares were to a large extent not covered by tangible assets.

The crisis of 1907 showed the weakness of the position. Many companies had to suspend payment of dividends on ordinary shares, and the public suffered immense losses even in the most prominent companies such as U.S. Steel Corporation. The capitalisation gap was only closed by 1914, thanks to the prosperous years which ensued after the 1907 crisis had been liquidated.

Though we have quoted only American instances of overcapitalisation by the issue of shares for property acquired at inflated prices, this technique was not restricted to the U.S.A.; it was indeed widespread everywhere.

In almost every boom period companies were formed to acquire going concerns or properties by the means of vendors transferring the properties either directly or through intermediaries in exchange for blocks of shares more or less disproportionate in amount to the actual values. The promoters secured large commissions for themselves, while the public were induced by prospectuses and other forms of propaganda to purchase shares which represented only small values in tangible assets. These shares, especially the ordinary shares, were therefore, as it were, drafts on a bright future. Every depression brought breakdowns with it, especially severe in times of real crisis. The weakness of the capital structure alarmed public opinion and in some cases led to legislative measures, though these came too late to be of use in the cases concerned and gave no adequate protection for the future.

We will now see how the various legislations have tried to deal with this matter.

In Great Britain the Company Act of 1862 allowed shares to be issued for consideration other than cash without any restrictions. A company could accept payment either in cash or in any other medium by agreement either prior or subsequent to the subscription, and no formalities were required. The Act of 1867, however, provided (sec. 25) that a contract permitting payment for shares by some consideration other than cash is to be made in writing, and to be filed with the Registrar of Companies at or before the issue, otherwise the share is to be paid in cash in full. Failure to file the contract was irreparable, and the

share was "deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash".

The Act of 1898 empowered the Court to give relief where no contract was filed, or where though filed it was not made between or signed by the proper parties or did not specify at all or correctly specify the consideration or the number of shares to be allotted under it. Relief could also be granted even where the shares in question were subscribed in the memorandum and the contract filed only afterwards, or when the contract merely gave an option to take shares. In order to obtain relief the company had to file an affidavit in which the circumstances of the omission were to be stated.[1] A settlement by setting off a debt presently payable by the company is regarded as payment in cash.[2]

Sec. 25 of the Act of 1867 was repealed by sec. 33 of the Act of 1900, but the Court's power to grant relief under the 1898 Act was not affected. In *re* Wilkinson Sword Co., Ltd.,[3] the Court permitted the filing after 24 years of a contract relating to shares subscribed in the memorandum.

Sec. 42 of the Act of 1929 prescribed that if shares have been allotted for a consideration other than cash, the company must within one month deliver to the Registrar a duly stamped contract in writing and a return stating the number and nominal amount of the shares so allotted, how far they are to be treated as paid up, and for what consideration they have been allotted. The contract must be in such form as to constitute the title of the allottee to the allotment. If there is any other contract of sale, for services or any other consideration for which the allotment was made, that also is to be delivered. Where any of the relevant contracts are not reduced to writing, the particulars of the agreement are to be made out in writing, stamped with the same stamp as would be payable if the contract had been reduced to writing, and delivered within the same period to the Registrar. In case of default every director or officer of the company who is knowingly a party thereto is liable to a fine not exceeding £50 for every day of the default. The Court may on application extend the time for delivery if it is satisfied that the omission is

[1] See Victoria Brick Works, W.N. (1898), 162.

[2] Spargo's case (1873), L.R. 8 Ch. App. 407, and White's case (1879), 12 Ch. D. 517. See also Laroque *v.* Brauchemin (1897), A.C. 358, and North Sydney Investment, etc., Co. *v.* Higgins (1899), A.C. 263.

[3] W.N. (1913), 27.

accidental or inadvertent or that it is generally just and equitable to do so.

But even if the contract was not filed it is nevertheless operative; it binds the company and the shareholder alike, and the shareholder is not bound to pay anything besides the consideration agreed on. This consideration may be property, whether real or personal or both, services rendered, or even future services.

The parties are perfectly free to settle their contract as they think fit. The Court will not review the contract, even in case of winding up, however disproportionate the consideration. The company may, however, attack the contract in case of fraud.[1] The company in such a case may rescind the contract and sue for cancellation of the shares either *in toto* or in part. Whether the vendors can be compelled to pay for the shares seems doubtful.

So far only the relations between the company and the vendors have been considered. The position is different if the public is invited to subscribe for shares in a company which has issued or intends to issue shares for a consideration other than cash, or if any part of the money to be raised by the issue is to be applied to the purchase of property. In such a case the public is to be given information in the prospectus (or statement in lieu). The formal requirements as to prospectuses have been discussed in general in § 44, and here we need consider only the special disclosure prescribed in the cases under consideration.

If any part of the proceeds of an issue is to be applied to defray the purchase price of any property purchased or to be purchased by the company either in whole or in part, this must be disclosed in connection with the statement of the minimum amount which in the opinion of the directors has to be raised (Fourth Schedule, sec. 5 (1)). The disclosure required is specified in detail. The points to be stated are the names and addresses of the vendors of any property purchased or acquired or proposed to be purchased or acquired by the company provided the purchase price is to be paid wholly or partly from the proceeds of the issue, or the purchase or acquisition is not completed at the date of the issue of the prospectus; the amount payable to the vendor or vendors, with a statement of what is payable in cash, debentures or shares (sec. 18). If there is more

[1] *Re* Wragg, Ltd. (1897), 1 Ch. 796; Hong Kong and China Glass Co. *v.* Glen (1914), 1 Ch. 527; *re* James Pitkin & Co., W.N. (1916), 112.

than one property the amount payable for each is to be specified, as is any amount paid or payable for goodwill (sec. 9).

The provision as to material contracts already discussed (see § 44) has, of course, considerable bearing when property is purchased, as also the obligation to state the interest of any director in such property (sec. 15).

If the property consists of a going business concern, a report by accountants named in the prospectus is to be set out in the prospectus on the profits of the business in respect of each of the three financial years immediately preceding the issue of the prospectus (Part II, sec. 2). If the business has been carried on for less than three years the report is to cover one or two financial years, as the case may be (Part III, sec. 5).

The purchase price for which the vendor or vendors have acquired the property in question need not be disclosed, except where the purchase price due to the original vendor was not fully paid at the date of issue of the prospectus, or the purchase money is to be found wholly or in part out of the proceeds of the issue, or the contract depends for its validity or fulfilment on the result of the issue (Part III, sec. 2). Similar disclosure is required if within the two preceding years shares have been issued as fully or partly paid up otherwise than in cash (Part I, sec. 7).

In the U.S.A. many legislations contain the stereotyped provision that shares may be paid in money, property or services ("labour" as many statutes put it), and it is held that in the absence of constitutional or statutory provision to the contrary the corporation may accept payment of stock in property, labour or services.[1] When payment in property is admitted, that property may be of any class or kind, real or personal, choses in action, patents, trade marks or licences. There are a number of decisions to the effect that non-patented inventions, secret processes or formulas are not property for which shares may be issued.[2] The issue of shares for transfer of mining rights is as a rule admitted.[3]

Some statutes prohibit the issue and payment of shares for or in services. Others again admit labour or services already performed as a basis for the issue of shares, but exclude future

[1] See Branch *v.* Jessup, 106 U.S. 468; Colt *v.* North Carolina, 119 U.S. 248; Bank of Fort Madison *v.* Alden, 122 U.S. 372; Camden *v.* Stuart, 144 U.S. 104; and the decisions of State Courts quoted by Fletcher 5185, n. 18.

[2] Fletcher 5189, n. 94–6.

[3] Fletcher 5190.

services. At the time of the construction of the transcontinental railroads it was a common practice to make contracts with construction companies for building and equipping lines and to pay for them wholly or largely in bonds and stock. As mentioned earlier, such construction companies were frequently formed by promoters and directors, and this practice in certain cases led to abuses. In principle such contracts, i.e. the issue of shares for construction, were held admissible.[1]

The essential matter is that of valuation. State legislations manifest various types of regulation in this respect.

In Iowa it is provided that for the issue of stock for property, labour or services leave is to be obtained from the Executive Council of the State which must investigate the real value thereof (Code 8413, 8414). In the case of new railways or manufacturing companies, however, the expenses of formation and organisation and reasonable commissions may be taken into consideration (8415). Stock issued in contravention is void and the Attorney-General of the State may even sue for the dissolution of the corporation (8418).

On the other hand under some legislations the valuation made by the company, i.e. by its directors, is valid, except in case of fraud.

In general, however, there are two widely held views. One is the so-called "true value" rule, which means that if shares are issued for property, the property must at the time of the issue have a value equal to the par value of the shares, and if the value is deficient the shareholder concerned is liable for the difference. The other view is that good faith in valuation is the essential. This "good faith value" means that if the directors valued the assets which are the consideration for which the stock was issued in good faith, the valuation cannot be attacked subsequently if it proves to have been erroneous. Good faith, however, can be assumed only if the valuation was made with reasonable care according to sound business standards and the rules of ordinary business prudence. In some cases issue of stock was forbidden at the suit of minority shareholders; but generally the question arises only retrospectively, mainly as a consequence of the corporation's insolvency.[2]

It is to be remembered that in the case of railway and public

[1] Branch *v.* Jessup, 106 U.S. 468; Fogg *v.* Blair, 139 U.S. 118; Fletcher 5191, n. 10.
[2] Cf. Ballantine, ss. 345–7.

utility companies administrative control preceding the issue of stock and bonds is established by many State legislations. Similarly, inter-State railway and public utility holding companies are forbidden to issue securities before they have obtained the assent of the Interstate Commerce Commission [1] and the Security and Exchange Commission [2] respectively. The body competent to give assent is therefore in a position to check and supervise the valuation and thus protect both the stockholders and the public.

The "blue sky" laws of the various States and the Federal Securities Act of 1933 give general though indirect protection by their provisions on the public offering for sale of shares and other securities. Certain State legislations provide for official investigation of the assets; others empower the body responsible for the administration of the "blue sky" law of the State to limit the subscription price of the security.

The Federal Securities Act of 1933, as we have seen in § 22, requires detailed information in the Registration Statement and in the prospectus.

So far as acquisition of property for shares to be issued or the application of the proceeds of the issue for such acquisitions is concerned, the Registration Statement and the prospectus must contain: (*a*) the names and addresses of the vendors, the purchase price, any commission to be incurred or paid, and the names of those to whom such payment is to be made; (*b*) particulars of the interest if any of directors, principal executive officers and stockholders holding more than 10 per cent. of the aggregate stock or of any class of stock in the property acquired within the last two years; (*c*) the provision prescribing the disclosure of material contracts also of course operates in cases of acquisition of property; (*d*) if the proceeds of the issue or any part of it are to be applied directly or indirectly to the purchase of any business, audited balance sheets and profit and loss accounts for the last three financial years ending not more than ninety days prior to the filing of the Registration Statement (Schedule A, secs. 21, 22, 24 and 27). It is to be remembered that the S.E.C. may refuse the registration, but has no power to limit, i.e. to reduce the issue price of the shares.

The French law of 1867 in cases in which it was intended to issue shares for property requires two general meetings for the

[1] 49 U.S. C.A., s. 20. [2] 15 U.S. C.A., s. 49.

formation of the company. The first meeting has to resolve on the valuation of the consideration, i.e. the contribution of property, etc. Subsequently the valuation is to be made by commissioners appointed at the meeting and a report prepared. This report is to be considered at a second general meeting, which is called to resolve upon the taking over of the contribution other than in cash and the formation of the company. The report is to be exhibited for inspection for at least five days prior to this meeting. For a valid resolution a majority of at least one-quarter of the subscribers and of the subscriptions in cash is necessary. Those who contribute property have no vote even in respect of their subscriptions in cash. In the absence of a valid vote the formation of the company is inoperative. Even if the report be approved, an action for deceit or fraud may lie in the future if such an action can be maintained under the general rules of law.

These restrictive and protective measures do not, however, apply if the company is formed solely of persons who own the property to be transferred to the company and there are no extraneous subscribers (sec. 4 of law of 1867).

An Order of 8 August 1935 excluded certain categories of persons affected by adverse interests or disqualified in consequence of penal judgment from functioning as commissioners. If in spite of the prohibition such persons accept and exercise the office, they are liable to a fine, but the resolution carried by the meeting cannot be invalidated on the ground of the contravention.

Lastly, an Order of 31 August 1937 provides that in the case of companies which appeal for the savings of the general public, and *inter alia* of companies whose shares or other securities are dealt in on the Stock Exchange (*en Bourse*) or Curb Exchange (*en Banque*), at least one of the commissioners must be chosen from the panel of experts established at the Courts. Contravention of this rule makes the formation of the company void. This is actually the only measure which is suited to ensure a proper valuation and effective protection of the investor.

More effective guarantees are provided by Swiss law (O.R.). If shares are to be issued for contributions other than cash the name of the shareholder, the objects to be transferred, their value and reckoning as contribution together with the amount in shares to be issued to him are to be disclosed in the articles. Similar disclosure is to be made if property is intended to be acquired from shareholders or other persons (628). The *Gründer* must

report in detail on the substance and condition of the property, and show that the valuation is reasonable; at the same time the consideration in shares or otherwise is to be specified (630). The disclosure is to be made in the prospectus or the subscription list (631). The contracts relating to the contributions in property and its acquisition are to be put before the constituent general meeting (635). The vote on this matter must include at least two-thirds of the whole capital. It is to be treated as a separate subject on the agenda (636).

Under German law, since 1884, all details relating to contributions in property are to be inserted in the articles, otherwise they are inoperative as against the company. It was disputed whether an omission would involve nullity of the incorporation. This is now settled; according to § 20 (2) of the law of 1937 the validity of the formation and of the articles cannot be attacked for such omission. The company is deemed to be lawfully formed, and the vendor-shareholder is bound in such case to pay the par value of his shares and the premium, if any, in cash. After the registration of the company, however, an omission or defect which makes the relevant agreement or provision of the articles inoperative cannot be rectified by alteration or amendment of the articles. The company may solve the dilemma by using the special machinery prescribed for acquisitions of property exceeding in value one-tenth of the capital, the so-called *Nachgründung*, which will be considered presently. On the other hand valid agreements as to contributions and acquisitions of property may be altered after five years from registration of the company by special resolution (§ 145 (3)).

The earlier practice in Germany offered many instances of the issue of shares for property, and also of attempted evasions of the rules regulating such issues by forming the company with a capital paid fully in cash, and arranging for subsequent acquisition of the property by special contracts. This method of evasion was barred by a provision introduced in 1884, by which acquisitions of property, if effected within two years after registration of the company, are subject to the same rules as contributions in kind, i.e. the issue of shares for property.

Any asset which has an assessable value and is therefore able to be included among the company's assets in the balance sheet can be accepted as consideration for shares provided it is transferable. It may be real or personal property, any security,

including shares in other companies (A.G., K.A.G. or G.m.b.H.), even a partner's share in a partnership, patents, trade marks or patent licences, the business name—though only together with the business—choses in action, leases or goodwill, or a commercial or industrial enterprise as a going concern. Labour and services are however excluded, since under §§ 131 and 133 they cannot be accounted as an asset in the balance sheet. This is a marked difference from the Anglo-American view.

Property which is not actually in existence at the formation of the company cannot be taken as consideration for shares, nor can assets which are not transferable to the company, since the owner would be unable to comply with the requirement that the consideration must come into the free ownership of the company before the shares can be allotted.[1]

German doctrine stresses strongly that the act by which a person in consideration of shares to be issued to him transfers his property to a company to be formed is not a contract of sale and purchase but an act of corporate character. On the other hand it is recognised that it has certain features in common with contracts, especially in so far as the obligations and liabilities of the transferor are concerned. The main difference is held to be that the transfer is deemed to be final and the transferor cannot attack it for mistake or misrepresentation, or even for absence of capacity to contract. The R.G. held in one case that though the contract in itself could otherwise have been void the transferor could not avoid the transfer (123, 107). The company may claim damages for warranty or breach of conditions, but a cancellation of the shares was held to be possible only through a reduction of the capital.[2]

The case where property is acquired by the company for money or any consideration other than shares is held to be of strictly contractual character, though subject to the same restrictions and requirements as contributions for shares. Such contracts are governed in other respects by the same rules as contracts in general. Both the company and the other party have the rights of a vendor and purchaser respectively; they may sue for performance or for damages in case of breach of contract. Similarly cancellation or repudiation of the contract may take place if it could be done under the general rules.[3]

[1] Cf. Gadow, pp. 61–2.
[2] R.G. 68,274, cf. Mann, *Die Sachgründung*, 1932.
[3] Cf. Gadow, 63–4.

The *Gründer* must include in their report all circumstances which show the reasonableness of the consideration proposed for the property. Contracts made in view of the projected transfer to the company, the purchase price paid or production costs incurred within the last two years are to be disclosed; and if the property is a going concern, its earnings during the same period (§ 24).

The reports both of the board and of the management and that of the examiners must contain a certificate that the consideration paid or to be paid by the company is justified (§ 26). The documents containing the agreements in respect of the property, as well as the reports, are to be attached to the company's application for registration (§ 29).

The Court is empowered to refuse registration not only on the ground of the incompleteness of the reports prescribed (reports of the *Gründer*, of the board and management and of the examiners), but also if in its view they are obviously incorrect. Apart from this the law of 1937 introduced an innovation: the Court has the power and duty to examine whether the consideration fixed is reasonable, and should it be found obviously unreasonable registration is to be refused. Before deciding the Court must hear the parties (§ 31). There is an appeal against an order of the Court refusing registration.

The machinery provided is therefore amply sufficient in respect of checking and examination, and, as we have seen, German legislation—beginning with the reform of 1884—was most effective against abuses in promotions. Its defects appeared rather in other aspects of corporate life, especially in the field of management.

The British Companies Act 1947 altered the law in respect of shares issued for property only in two directions:

(1) short particulars of any transaction relating to property, completed within the two preceding years, are to be included in the prospectus, in so far as any vendor of the property or any other person who is or was at the time of the transaction a promoter or a director, or a proposed director of the company had any direct or indirect interest in the transaction (sec. 61 (1) (*c*)).

(2) if the property is a going concern, the period for which the reports as to its finances are to be set out in the prospectus is extended from three to five years (sec. 62 (2)).

These provisions are now incorporated in the Fourth Schedule, 9 (1), 19 and 20.

In our opinion it would have been preferable to require the disclosure of all transactions completed in respect of property within the relevant period, even if neither the vendor nor any promoter or director had any interest in them.

46. Liability for the Prospectus

In Great Britain the liability for failure to comply with the legal requirements regarding prospectuses under Common Law is to be distinguished from that under the Companies Act. The rules of Common Law relate to the rescission of the contract of subscription and the action of deceit. The statutory consequence, apart from fines, is the liability for compensation to persons who have subscribed on the faith of the prospectus. Under the Act of 1948 (sec. 35 (6)) the liability under the general law is neither limited nor diminished.

The possibility of rescission depends on the impact of the defect, i.e. whether and how far the omission or misstatement is material; in other words, whether the subscriber would in full knowledge of the facts have subscribed to the shares or not.

Even before the contents of a prospectus were laid down by legislation the Courts took a rather strong view about the material disclosure required. It was said by Kindersley, V.C.,[1] that those who issue a prospectus "are bound to state everything with strict and scrupulous accuracy and not only to abstain from stating as fact that which is not so but also to omit no one fact within their knowledge the existence of which might in any degree affect the nature or extent or quality of the privileges and advantages which the prospectus holds out as inducement to take shares". Similarly Lord Chelmsford stated,[2] that "no misstatement or concealment of any material fact or circumstance ought to be permitted; that the public who are invited by a prospectus to join in any new venture ought to have the same opportunity of judging everything which has a material bearing on the true character of the adventure as the promoters themselves possess, and that the utmost candour ought to characterise their public statements".

[1] New Brunswick, etc., Co. *v.* Muggeridge (1860), 1 Dr. & Sm. 363.
[2] Central Railway of Venezuela *v.* Kisch (1867), L.R. 2 H.L. 99, at p. 123.

These admirable principles were not always applied in fact with the rigour to be expected. Thus,[1] it has been held that proof of mere non-disclosure of material facts is not enough to entitle a plaintiff to relief by way of rescission. Likewise, Lord Watson [2] held that the omission to mention that the directors received their qualifying shares from the contractor of the company as a gift does not entitle the subscriber who took his shares on the faith of the prospectus to rescind his subscription. On the other hand it is recognised that an omission may be apt to falsify the prospectus. Lord Chancellor Halsbury,[2] held that it was immaterial by what means the false statement was conveyed: "by what trick or device or ambiguous language . . . If by a number of statements you intentionally give a false impression and induce a person to act upon it, it is not the less false although if one takes each statement by itself there may be a difficulty in showing that any specific statement is untrue." Again,[3] it has been held that if a prospectus makes such a partial disclosure as to the source of the profits out of which dividends have been declared it may be false.[4]

If a company had nothing to do with the prospectus, rescission of the subscription was not allowed, and the subscriber had therefore to show that the prospectus was issued by the company or by someone with authority to act on its behalf. For a prospectus issued by the board of directors the company is of course responsible, and it cannot sue on a contract if the statements were false or misleading.[5]

If the board of directors has ratified and adopted the issue the company is responsible for a prospectus issued exclusively by the promoters.[6] The same is true if the company allots the shares in the knowledge that they have been subscribed on a particular prospectus or statement of facts.[7]

[1] McKeown *v.* Boudard Beveril Gear Co. (1896), 74 L.T. 712.
[2] Aarons' Reefs *v.* Twiss (1896), A.C. 273.
[3] Rex *v.* Kylsant (1932), 1 K.B. 442.
[4] See also Peek *v.* Gurney (1873), L.R. 6 H.L. 377, at p. 473; Derry *v.* Peek (1889), 14 App. Cas. 337; Heymann *v.* European Central Railway Co. (1868), L.R. 7 Eq. 154; Greenwood *v.* Leather Shod Wheel Co. (1900), 1 Ch. 421, C.A.
[5] National Exchange Co. of Glasgow *v.* Drew (1855), 2 Macq. 103; Houldsworth *v.* City of Glasgow Bank (1880), L.R. 5 App. Cas. 317.
[6] Pulsford *v.* Richards (1853), 17 Beav. 87; Jennings *v.* Broughton (1854), 5 De G.M. & G. 126; 17 Beav. 234.
[7] Henderson *v.* Lacon (1867), L.R. 5 Eq. 249; Ross *v.* Estates Investment Co. (1868), L.R. 3 Ch. App. 682; Lynde *v.* Anglo-Italian, etc., Co. (1896), 1 Ch. 178; and Karberg's case (1892), 3 Ch. 1.

It makes no difference that a misrepresentation for which the company is responsible was an innocent one.[1]

The misrepresentation must be one of fact.[2] What facts are material depends upon the circumstances. It seems superfluous to give details as to what facts have been held material in the cases. But statements in a prospectus as to the persons of directors are held to be material. Thus a person subscribing on the faith of such a statement is *prima facie* entitled to rescind.[3]

A clear difference is made between statements of fact and statements merely of belief or opinion. As a rule the latter are not held to be material, but in some cases statements of intention or expectation may operate in the same way as statements of fact.[4]

A prospectus which refers to reports implies responsibility for their contents unless the directors are able to show that they had reasonable ground to believe that the report was true, and that the person making the statement was competent to make it. On the other hand, if the prospectus contains a mere reference to or extract from the report, they have to show that the statements contained in the prospectus are reasonably conformable to the report.

The subscribers are entitled to rely upon the prospectus and are not bound to verify its contents. Even if a document is offered for inspection, the subscriber is not bound to inspect it, and he may assume that the statement as to its terms contained in the prospectus is true.[5]

It is held that persons other than the subscribers have no right to rescind their contracts for the purchase of shares as against the company if the shares were not allotted to them but purchased in the market, even though they prove that they bought on the basis of the prospectus.[6] This rule has, however, been held not to apply where it was shown that the prospectus was intended to be and was in fact used to induce purchasers in the market to buy shares.[7]

The Courts are still inclined to apply strictly the rule of

[1] Smith's case (1867), L.R. 2 Ch. App. 604; Reese River, etc., Co. (1869), L.R. 4 H.L. 64; London and Staffordshire Co. (1883), 24 Ch. D. 149.

[2] Eaglefield *v.* Londonderry (1878), 4 Ch. D. 388.

[3] *Re* Scottish Petroleum Co. (1883), 23 Ch. D. 413; from later cases Kent County Gas, etc., Co. (1906), 95 L.T. 756.

[4] See Edgington *v.* Fitzmaurice (1885), 29 Ch. D. 459, per Bowen L.J., at p. 483.

[5] See Redgrave *v.* Hurd (1881), 20 Ch. D. 1; Smith *v.* Chadwick (1884), 9 App. Cas. 187; *Re* Mount Morgan (West) Gold Mine Co. (1887), 56 L.T. 622.

[6] See Peek *v.* Gurney (1873) L.R. 6 H.L. 377.

[7] Andrews *v.* Mockford (1896), 1 Q.B. 372.

privity of the contract. Thus in a case where an allotment was made to two persons who acted as trustees for the plaintiff and the allotment letter was renounced in favour of the plaintiff before registration, it was held that he could not rescind, although the trustees read and relied upon the prospectus.[1]

For misrepresentation the contract of subscription is not void but merely voidable. It is therefore valid until rescinded, and the subscriber may remain bound to the voidable contract because he did not act promptly after discovering the misrepresentation. The time within which he is entitled to rescind depends on the circumstances. A delay of fourteen days was held in one case to be material. It is not necessary that he should have absolute and complete knowledge; if he has been told that there was misrepresentation and he remains inactive, he will lose his right.[2] Ratification of course excludes rescission. The same applies to an implied ratification. If after having discovered the misrepresentation the subscriber endeavours to sell the shares or executes a transfer, he loses his right to rescind.[3]

Transfer of part of the shares before discovery does not preclude relief in respect of the remainder.[4] Paying calls or receiving dividends has been held to exclude relief.[5] Attendance and voting at a general meeting in person or by proxy is generally a bar to rescission;[6] but if a subscriber has previously issued a writ claiming rescission and has thus definitely elected rescission, his subsequent attendance at a general meeting does not exclude it.[7]

If the company goes into liquidation rescission is no longer possible.[8] It is otherwise if the subscriber has already rescinded the contract before the beginning of the winding-up.

The restrictions relating to rescissions do not apply if the allotment was irregular under the Companies Act; in such case it is sufficient to give notice of the avoidance to the company.[9]

In case of a successful rescission the subscriber has the right

[1] Collins *v.* Associated Greyhound Racecourses, Ltd. (1930), 1 Ch. 1.

[2] Ashley's case (1870), L.R. 9 Eq. 263; Scholey *v.* Central Ry. Co. of Venezuela (1870), L.R. 9 Eq. 266 n.; Christineville Lumber Estates (1911), W.N. 216.

[3] *Ex parte* Briggs (1866), 35 Beav. 273; Crawley's case (1869), 4 Ch. App. 322.

[4] *Re* Mount Morgan (West) Gold Mine Co. (1887), 56 L.T. 622.

[5] Scholey *v.* Central Ry. Co., *supra*; *re* Dunlop Truffault Cycle Co., *in re* Shearman (1896), 66 L.J. Ch. 25.

[6] Sharpley *v.* Louth, etc., Co. (1876), 2 Ch. D. 663.

[7] Tomlin's case (1898), 1 Ch. 104.

[8] Oakes *v.* Turquand (1867), L.R. 2 H.L. 325; Burgess' case (1880), 15 Ch.D. 507; Reese River, etc., Co. *v.* Smith (1869), L.R. 4 H.L. 64.

[9] See National Motor Mail Coach Co. (1908), 2 Ch. 228; Clark *v.* Urquhardt (1930), A.C. 28.

to demand the restoration of his former position, that is the repayment of the sum paid by him and relief in respect of further payments. No action for damages can be maintained against the company, particularly not for the loss of profit, even if such profit could have been expected in view of the statements in the prospectus.

Damages may be claimed for deceit by a common law action. Its basis is fraud, which is to be proved by plaintiff. "There must be proof of fraud, and nothing short of that will suffice. Fraud is proved when it is shown that a false representation has been made: (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false." [1] Mere negligence is not sufficient, nor can the action be maintained if he who made the representation honestly believed it to be true, though on insufficient grounds. Against an action for deceit it is no defence that the subscriber could have found out the facts by searching, but defendant may prove that plaintiff was not deceived, since he had knowledge of the facts.[2] Thus an action for deceit can succeed only in exceptional cases. This state of law led in 1890 to the introduction of the statutory liability of directors by 53 & 54 Vic., c. 64.

By sec. 37 of the Companies Act 1929 liability for the prospectus is imposed upon: (*a*) every person who is a director of the company at the time of the issue of the prospectus; (*b*) every person who with his consent is named in the prospectus as a director, or as having agreed to become a director either immediately or after an interval of time; (*c*) every promoter; and (*d*) every person who authorised the issue of the prospectus (sec. 37 (1)). There is no responsibility if defendant proves that although he had consented to become a director, he had withdrawn his consent before the issue of the prospectus, and thus the prospectus was issued without his authority or consent. Alternatively he may prove that on becoming aware of the issue of the prospectus without his knowledge or consent, he forthwith gave reasonable publicity thereof. Even if defendant gave his authority or consent to the issue of the prospectus, he may exclude his liability by proving that on becoming aware of any untrue statement he withdrew his consent and gave reasonable public statement of the withdrawal and the reason therefor. Such

[1] *Per* Herschell, L.C., in Derry *v.* Peek (1889), 14 A.C. 337.
[2] Cf. Buckley at p. 240; Palmer at pp. 348–50.

withdrawal, however, is operative only if it was made public before allotment.

Generally the defendant may exclude liability by proving that he had reasonable ground to believe that the statement was true and did so believe up to the time of the allotment.

If the untrue statement was made on the authority of an expert it is sufficient to show that it fairly represented the expert's statement or was a fair copy of or an extract from the expert's report or valuation. The same applies in the case of untrue statements made by reference to statements of official persons or to public official documents, if the statement was a correct or fair statement of the official person's statement or a correct and fair copy of or an extract from the document. The plaintiff, however, may claim compensation if he proves that the defendant had no reasonable ground to believe that the person making the statement, report or valuation was competent to make it (sec. 37 (1)).

Every person is entitled to claim compensation who subscribed for shares on the faith of the prospectus, and the compensation is for the loss or damage sustained by reason of the untrue statement. The amount of the damage is the difference between the price paid by plaintiff and the real value of the shares or debentures.[1] The liability is joint and several.

The position of the persons liable under sec. 37 is eased by two provisions. Under subsec. (2) of sec. 37, a person who was named in the prospectus as a director of the company, or as having agreed to become a director, although he did not give his consent or has withdrawn it before the issue of the prospectus and has not authorised or consented to the issue thereof, may claim indemnity for all damages, costs and expenses incurred by reason of his name being inserted in the prospectus or by his defence against actions or other legal proceedings started against him in respect thereof from all the directors of the company and all other persons who authorised the issue of the prospectus. Directors without whose knowledge or consent the prospectus was issued are exempt from this liability to indemnify. On the other hand any director or other person who has had to make payment for his liability for the prospectus may recover contribution under the general rules of the law of contracts from any other person who if sued separately

[1] Cackett *v.* Keswick (1902), 2 Ch. 456; Exploring Land and Minerals Co. *v.* Kölckmann (1905), 94 L.T. 234.

would have been liable to make the same payment. Such contribution, however, may not be claimed by persons who were guilty of fraudulent misrepresentation from those who were innocent thereof (sec. 37 (3)).

The period of limitation in respect of actions for untrue statements is six years (sec. 2 (1) of the Limitation Act 1939). It begins when the plaintiff sustained the damage.[1]

The same liability for untrue statements is imposed in respect of debentures. The liability of promoters is considered in § 47.

In the U.S.A. both the action of deceit, i.e. fraud, and the right to rescind the subscription for misrepresentation are recognised. The misrepresentation must be one of fact; expressions of opinion do not entitle the subscriber to rescission. It must originate from the company, i.e. the directors or their agents; the effect of misrepresentations by promoters is disputed, and there are decisions holding that in case of misrepresentation by promoters the subscriber may not rescind the subscription. He may or may not have a remedy by way of an action of deceit according to the circumstances. The subscriber may lose his remedy by laches either of discovery of the misrepresentation or in the exercise of his right to rescind.

It is generally held that as against creditors already existing at the time of the subscription insolvency of the corporation is no bar to rescission. As against persons who gave credits to the corporation subsequent to the subscription the majority rule seems to be that a rescission is operative provided the subscriber acted without unreasonable delay; but there are decisions to the contrary on the basis that creditors presumably acted on the faith of the subscriptions which appeared to be valid.[2]

Under the Federal Securities Act 1933, if a security—with the exception of those guaranteed by the Government—is sold in inter-State commerce by means of a prospectus or even merely by oral communication including an untrue statement of a material fact or omitting a material fact necessary under the circumstances to give fair information so that the statement or omission is apt to mislead the purchaser having no knowledge of the untruth or omission, the seller is liable, unless he can prove that he had no knowledge and by exercise of reasonable care could not have had knowledge of the untruth or omission.

[1] Thomson *v.* Lord Clanmorris (1900), 1 Ch. 718.
[2] Cf. Ballantine, s. 342.

The purchaser may recover the consideration paid for the security plus interest, less the amount of any income received, upon tender of the security, which amounts in fact to rescission of the contract. He is, however, entitled to sue for damages if he no longer owns the security (sec. 12). These actions may be maintained only within one year after the discovery of the untruth or omission of any material fact, and in no case after three years from the sale (sec. 13).

French law from 1867 (Art. 15 of the law) has provided rules to the effect that those who obtain or try to obtain subscriptions to capital or payments thereof by false statements are to be punished under Arts. 405 and 463 of the Penal Code. Beside this general clause simulation of subscriptions, *mala fide* statements of non-existing subscriptions and *mala fide* statements that persons named have joined or are to join the company in whatever capacity are especially declared to be punishable under the above-mentioned articles. It is held by the Courts that these penalties apply in view of the general clause quoted to any false statement, e.g. as to the past of the enterprise, its results, the contributions of property (*apports*) and so on.[1] This provision was maintained and extended by the Order of 8 August 1935. These offences of course involve liability for damages.

By Swiss law statements in prospectuses, circulars and similar publications in so far as they are incorrect or do not comply with legal requirements make the persons who co-operate therein either voluntarily or by negligence liable for damages to any subscriber (752). The provision extends to every subsequent prospectus or publication and protects bondholders as well.

In German law the position is dominated by the principle that a subscription is not rescissible. The law of 1937, however, provides that a person who has offered shares to the public before or within two years after registration of the company is liable to the company if he had knowledge of the incorrectness or incompleteness of the statements made for the purpose of incorporation or of the damage caused to the company in respect of contributions in or acquisitions of property. The same liability is imposed if the person making the statement might have had knowledge of the untruth or lack of completeness if he had applied the diligence of an ordinary business man (§ 40, 3). The liability is joint and several. False statements or concealment of material

[1] Rouen, 26 July 1912, D.P. 1916, 2, 113.

facts involve liability to imprisonment up to five years (§ 295, 1 (2)). Communications to a restricted circle of persons, e.g. invitations addressed by a bank to its customers are held not to be public offers.[1]

It is held that the company must prove that the issuer of the prospectus or any person who collaborated had actual or constructive notice of the untruth or incompleteness of the prospectus.[2]

For the introduction of shares or other securities for dealings on the Stock Exchanges the issue of a prospectus is prescribed by the law of 1895 on Stock Exchanges. Under this law the issuer of a prospectus and any person who authorised it is liable for damages to every person who acquired the share or other security after it was admitted to dealings provided the purchase was made in Germany. In the case of untruth the liability is restricted to cases of actual knowledge of the untruth or of lack of knowledge caused by gross negligence. In cases of incompleteness liability is incurred only if the persons responsible for the prospectus have *mala fide* omitted relevant facts or sufficient examination. Whether the prospectus refers to facts as originating from third parties is immaterial. There is no liability if the purchaser had knowledge of the facts at the time of the purchase, or could have had knowledge by applying the diligence he is wont to apply in his own affairs. Neglect of such diligence, however, does not exclude liability for fraud. The claim for damages may be averted by payment of the purchase price quoted at the introduction of the security.

The action is subject to a five years' limitation (§§ 45–9 of the Exchange law).

The British Companies Act of 1947 introduced amendments to clear up certain doubts, and regulated the liability of persons named as experts.

Statements shall be deemed to be included if they are contained not in the prospectus or in the statement in lieu but in a report or memorandum appearing on the face thereof or incorporated therein by reference or issued therewith (sec. 68 (4) (*b*)).

Any statement shall be deemed to be untrue not only if it is false but also if it is misleading in the form or context in which it is included (sec. 68 (3)).

A person who consents to be named as an expert is liable

[1] R.G.Z. 39, 248. [2] Gadow, n. 10, p. 134.

only for untrue statements purporting to be made by him in that capacity. He may avail himself of one of the following lines of defence: (1) that he withdrew his consent in writing before the issue of the prospectus; (2) that after the issue of the prospectus but before the allotment, he, becoming aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and its reason; or (3) that he was competent to make the statement and had reasonable ground to believe and actually did believe up to the time of allotment that the statement was true. The *onus probandi* is upon the expert, and if he has not given his consent or has withdrawn it, he shall be entitled to indemnity on the same terms as a person who was without his consent named as a director of the company (sec. 65 (1) (2)). The liability of directors and other persons responsible for untrue statements attributed to experts is strengthened in so far as they will have to prove not only that the statement is a correct and fair copy of or extract from the report or fairly represents the report, but also that they had reasonable ground to believe and did up to the time of the issue of the prospectus actually believe that the expert named was competent to make the statement and that he consented to the issue of the prospectus (sec. 65 (3)).

In respect of contributions the law was altered, and in future not the rules of the law of contracts but the provisions of the Law Reform Act 1935, or for Scotland those of sec. 3 of the Law Reform (Scotland) Act, shall apply (sec. 65 (4)). This means that the Court will have power to fix the contribution at such amount as it thinks fit and equitable having regard to the extent of responsibility for the damage on the part of the person concerned. It may also exempt any person or direct that the contribution to be recovered from him shall amount to a complete indemnity.

Lastly the Act provided a special regulation in respect of the criminal liability for the prospectus. Heretofore directors could only be prosecuted under sec. 84 of the Larceny Act 1861 (24 & 25 Vic., c. 96). The penalties under this Act are severe, but in order to find a director guilty of misdemeanour thereunder the Court had to find that the prospectus contained statements known to be false and made with the intent to induce some person to become a shareholder of the company. Now the liability is imposed simply for untrue statements. Liability extends to any

person who authorised the issue of the prospectus, but the consent of an expert to include his statement is not deemed to be an authorisation of the issue of the prospectus.

A person who proves either that the statement was immaterial or that he had reasonable ground to believe and up to the time of the issue of the prospectus did actually believe that the statement is true, is not liable.

The penalty on conviction on indictment is imprisonment for a term not exceeding two years or a fine not exceeding £500 or both; on summary conviction imprisonment for a term not exceeding three months or a fine not exceeding £100 or both (sec. 66). These amendments are now incorporated into secs. 43–46 of the Act of 1948.

47. Promoters and their Liabilities

There is no exhaustive legal definition in English law of the word "promoter". Sec. 37 of the Companies Act of 1929 defined the word only for the purposes of that section, in relation to compensation for untrue statements in the prospectus, saying only that by a promoter is meant one who was "a party to the preparation of the prospectus or of the portion thereof containing the untrue statement". The Act expressly excludes "any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company". Sec. 43 (5) (*a*) contains the same definition.[1]

Actually the expression is used in a much wider sense, and as a term of business rather than of law. A promoter in the fullest sense is one who initiates the formation of a company, negotiates with the vendors of property to be acquired by it, organises the board of directors, prepares or provides for the preparation of the memorandum and articles of association, employs solicitors for that purpose, drafts the prospectus, pays the registration fees, meets the necessary expenses of the issue of the prospectus, and makes arrangements for its issue with bankers and brokers. As Cockburn, C.J., stated,[2] a promoter is "one who undertakes to form a company with reference to a given project, to set it going and to take the necessary steps to accomplish that purpose".

[1] Cf. Gold, 5 Univ. of Toronto Law Journal, pp. 21 and 70.
[2] Twycross *v.* Grant (1877), 2 C.P.D. 469, at p. 503.

In many cases, however, promoters do not perform all these functions at the same time: one or another of them is performed by other persons. The Court in its discretion will decide whether the activities of the person in question justify the conclusion that he took an active part in bringing the company into existence.

The question whether a given person was a promoter generally arises in connection with an action for damages or for recovery of money belonging to the company. It is therefore always a question hotly disputed between the company, its shareholders or the receivers on the one side, and the persons sued on the other. English Courts have established liability for promotions against persons who did no more than solicit others to agree to serve as directors, or undertook only to negotiate an agreement for the company with the stipulation that some fee, commission or consideration should be payable to them if the company were floated. An agreement by which someone undertakes to place shares is undoubtedly promotion. In short, whether a given person is a promoter or not is a question of fact.

Promoters are in a fiduciary relation with the company. According to Lord Cairns' statement,[1] "the promoters of a company stand undoubtedly in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under what supervision it shall start into existence and begin to act as a trading corporation".

The duties of a promoter cannot be based on the assumption that he is an agent for the company, since no one can act as agent for a company which does not as yet exist. Another popular explanation of the promoter's duties is that he is a trustee for the company. It is true that one can act as a trustee for persons not yet in existence. Yet promoters are certainly not trustees in the technical sense of that term. It is therefore both more correct and also sufficient to define the position of promoters as a fiduciary relationship.

The main obligation of a promoter is to abstain from taking or securing any undisclosed profit in connection with the promotion. If a promoter acts openly and discloses fully and unambiguously his interest in the promotion and the profits accruing to him, neither the company nor the shareholders may disturb him in the possession or enjoyment of such profits. If,

[1] Erlanger *v.* New Sombrero Phosphate Co. (1878), L.R. 3 App. Cas. 1218, at p. 1236.

however, he has made secret profits, the company may bring action against him and he will have to disgorge them. This is an established rule,[1] which has been consistently upheld by the Courts, although there is much dispute as to the details.

The first question is to whom disclosure is to be made. On this it has been asserted that promoters are bound not only to disclose their agreement as to profits to the shareholders at the time of the formation of the company, but also to provide for an independent body of directors. This view, however, is not held strictly, and it is safe to say only that if the original shareholders and the directors are mere nominees of the promoters, disclosure to them does not absolve the promoters from their liability.[2] If, however, all the shareholders have been informed of the real facts of the case, the absence of an independent board will not invalidate the agreement.[3]

To illustrate the point of the law we may quote Lindley, M.R., in the Lagunas case: "Notwithstanding all that has been said in Erlanger *v.* New Sombrero Phosphate Co. about the duties of the promoters of a company to furnish it with an independent board of directors, that decision does not require or indeed justify the conclusion that if a company is avowedly formed with a board of directors who are not independent but who are stated to be the intended vendors or the agents of the intended vendors of property to the company, the company can set aside an agreement entered into by them for the purchase of such property simply because they are not an independent board. After Salomon's case I think it impossible to hold that it is the duty of the promoters of a company to provide it with an independent board of directors if the real truth is disclosed to those who are induced by the promoters to join the company." On the other hand it was stated by Lord Chancellor Halsbury,[4] that it would be absurd to suggest that a disclosure to those who were parties to a transaction which cheated the shareholders should be treated as a disclosure to the company.

A difficult question arises with regard to subsequent shareholders. It has been asserted and upheld in several judgments

[1] See Fawcett *v.* Whitehouse (1829), 1 Russ. and My. 132, and Hichens *v.* Congreve (1831), 4 Russ. 562.

[2] Erlanger *v.* New Sombrero Phosphate Co. (1878), L.R. 3 App. Cas. 1218.

[3] Salomon *v.* Salomon (1897), A.C. 22; British Seamless Paper Box Co. (1881), 17 Ch. D. 467; Lagunas Nitrate Co. *v.* Lagunas Syndicate (1899), 2 Ch. 392; *re* Sale Hotel and Botanical Gardens (1898), 78 L.T. 368.

[4] Gluckstein *v.* Barnes (1900), A.C. 240, at p. 247.

that a company is prevented from bringing action if the original shareholders have been informed regarding secret profits even though other shareholders have subsequently joined the company without being informed regarding them. Even those who take this view of course agree that if the directors, or they and their nominees, were themselves the promoters, then action lies, and there is much to be said for the view that even if the company had an independent board, it may sue if there was no full disclosure to the shareholders, since it is obvious that shareholders who subscribe after the original allotment do so on the basis of the information given to them. In so far as they were not informed of profits accruing to the promoters they may assume that such profits do not exist or exist only in so far as they were communicated.

Where promoters and their nominees or associates subscribe the whole capital and shares are subsequently sold, the question as to the absence of knowledge by shareholders who became such by purchase is disputed. There are dicta in some cases asserting that the company may sue and the knowledge of the original shareholder does not prevent the action. This view is contrary to the general rule that transferees cannot have more rights than had their transferors. The question is obscured by the fact that in all cases in which promoters were compelled to compensate the company there were some original shareholders who actually had no knowledge of secret profits. On the other hand in most cases the action could be based upon the alternative basis of the incorrectness or incompleteness of the prospectus.

In order to exclude liability disclosure must be full. The facts are to be definitely and completely stated. It is not sufficient for a promoter to make a statement which might cause shareholders to institute inquiry. Such statements, even if they enable the inquirer to ascertain the fact that profits have been made and their amount, will not exclude liability.[1] An incomplete disclosure may be equivalent to non-disclosure or even worse, since a partial concealment is apt to falsify the whole statement.[2] If there were secret profits the company may rescind the transaction. It may on the other hand choose to abide by the transaction and sue the promoters to recover the secret profits.

The promoter has to surrender all profits that are not

[1] *Re* Olympia Ltd. (1898), 2 Ch. 153 C.A.; Gluckstein *v.* Barnes (1900), A.C. 240.
[2] Gluckstein *v.* Barnes, *supra*.

disclosed. In so far as the secret commission has not yet been paid to the promoter the company may sue the vendor, who cannot object the illegality of the promise. The promoter is not exempted from liability if he was at the same time the vendor's agent; his paramount duty even in such a case is to the company.

The measure of liability is the amount of profit realised or secured, e.g. the difference between the price which the promoter had to pay to the vendor for the property and the price which the company had to pay to him. If the profit consists in a commission, the promoter is liable up to the amount of this commission. This liability is quite distinct from that arising from a rescission. But if rescission has become impossible the company may sue the promoter for damages, and in such a case the company may demand payment of the difference.[1]

Under the existing law a promoter who acquires a property on his own account and subsequently sells it to the company is not bound to disclose the purchase price paid by him, unless the transaction took place within the last two years. But if he purchased the property with a view to its transfer to the company he must disclose both the price and his profit in order to exclude liability. This is expressed in the formula that he acquired the property as a trustee for the company. There is no presumption that he did so;[2] it is a question of fact to be determined by the Court.

A promoter's profit may consist in the price-difference yielded by the re-sale of shares allotted to him. It has been held[3] that a promoter who received an allotment of shares before the filing of a statement in lieu of prospectus must account to the company for the profit made on their re-sale. Although an action brought by a receiver is on the same footing as an action by the company, the Courts are inclined to deal with such actions on a basis less favourable to the promoter.

Generally a promoter who is liable for secret profits is in the position of a constructive trustee; a claim against him will be barred after six years from the discovery of the facts.[4]

In many cases promoters seek direct remuneration from the company. Without an agreement a promoter is not entitled to

[1] Leeds and Hanley Theatres of Varieties (1902), 2 Ch. 809, C.A.
[2] Omnium Electric Palaces *v.* Baines (1914), 1 Ch. 332.
[3] Jubilee Cotton Mills *v.* Lewis (1924), A.C. 958.
[4] Metropolitan Bank *v.* Heiron (1880), 5 Ex. Div. 319.

claim compensation or even reimbursement of his expenses.[1] Actually, however, promoters will be able to secure compensation beside such reimbursement. The compensation may be substantial, and its amount does not stand in the way of the validity of the agreement. Lord Chancellor Hatherley stated:[2] "The services of a promoter are very peculiar. Great skill, energy and ingenuity may be employed in constructing a plan and bringing it out to the best advantage." The compensation therefore may be well earned. This, however, is immaterial from the law's point of view. The important point is only that full disclosure should be made.

The compensation of promoters may consist in an option to subscribe within a certain time for some part of the company's unissued shares. It will be valid regardless of the value which such option may represent at the time of its exercise.[3]

Whether or not a clause in the articles authorising the directors to pay a specified sum to the promoters for their services constitutes a contract depends on the circumstances. In itself such a clause does not constitute a contract.[4] Furthermore the directors are not authorised to pay out such amounts without due inquiry.

The law in the United States is on the whole similar.[5] In Old Dominion Copper Mining and Smelting Co. *v.* Bigelow,[6] Rugg, J., stated that the word "promoter" has no precise and inflexible meaning in the U.S.A.; at the same time he gave the following definition: "In a comprehensive sense 'promoter' includes those who undertake to form a corporation and to procure for it the rights, instrumentalities and capital by which it is to carry out the purposes set forth in its charter and to establish it as fully able to do business. Their work may begin long before the organisation of the corporation in seeking the opening for a venture and projecting a plan for its development, and it may continue after the incorporation by attracting the investment of capital in its securities and providing it with the commercial breath of life."

[1] See English and Colonial Produce Co. (1906), 2 Ch. 435; National Motor Mail Coach Co. (1908), 2 Ch. 515.

[2] Touche *v.* Metropolitan, etc., Co. (1871), L.R. 6 Ch. App. 671.

[3] *In re* South African Trust and Finance Co., *ex parte* Hirsch (1896), 74 L.T. 769; see also Hilder *v.* Dexter (1902), A.C. 474.

[4] Rotherham Alum., etc., Co. (1883), 25 Ch. Div. 103.

[5] Cf. Ballantine, ss. 35–41, 356–64.

[6] (1909), 203 Mass. 159.

As in England, it is generally held that a promoter is not entitled to any compensation for his services or to the reimbursement of his expenses in the absence of an agreement, which is to be made after incorporation. The adoption of a pre-incorporation contract is also a sufficient basis for such a claim. An agreement or the ratification of a pre-incorporation agreement may be implied, especially if the corporation enjoys the benefit of that contract. Some Courts, however, hold that even in the absence of express or implied agreements promoters are entitled to reasonable compensation for necessary services and the reimbursement of reasonable expenses.

It is generally held that a promoter stands in a fiduciary relation with the corporation; "it is now established without exception that a promoter stands in a fiduciary relation to the corporation which he is interested in and that he is charged with all the duties of good faith which attach to other trusts. In this respect he is held to the high standards which bind directors and other persons occupying fiduciary relations".[1] The analogy of a trustee is often used, although it is recognised that a promoter's position is not from a technical point of view identical with a trustee's. There is indeed a substantial difference: a promoter in most if not all cases looks to a profit; he is not satisfied merely with the prosperity of the company, and even when he takes shares his aim is to secure individual profits for himself for his services in promoting the company. This aim is not regarded as being contrary to law or public policy, and the Courts have no power to review the extent of the profits, however disproportionate they may be to the actual services rendered.

In order, however, that the agreement should stand full disclosure is necessary. Such disclosure is immaterial if the promoters are themselves the subscribers of the whole authorised capital of the corporation. In the Old Dominion Copper Mining cases there was some difference in judicial opinion. A fraction of the capital was subscribed by subscribers who were outside the circle of the promoters and who were not informed regarding the profits which the promoters stipulated for themselves. In one case,[1] the Supreme Court of Massachusetts [2] held one of

[1] Old Dominion Copper Mining and Smelting Co. *v.* Bigelow (1909) 203 Mass. 159.
[2] (1905), 188 Mass 315.

the promoters liable and on the merits gave judgment for the plaintiff,[1] although in the meantime the Supremè Court of the U.S.A. dismissed the action of the same corporation against another of the promoters in another case.[2] In this case the position of the subscribers outside the circle of the promoters was not made quite clear, and this technicality may have played some part in the decision of the S.C. Nevertheless it was held that incoming shareholders did not change the position of the company. Further, it was stressed that if the corporation should recover, the promoters guilty of non-disclosure would share the benefit of recovery in proportion to their shareholdings.

In Davis *v.* Las Ovas Co.,[3] however, it was held that if certain of the subscribers—who were themselves promoters—had no knowledge of the profits secured by other promoters, the corporation might recover, and that this right "results from the fact that they were innocent and deceived members of the corporation when the property was taken over by it". In a case in which through profits secured by the promoters the corporation was saddled with liens beyond the value of its assets and in two years came into receivership, the S.C. held that the receiver could recover the profits accruing from the sale of the bonds and mortgage notes and that "no consent of the shareholders could make such conduct lawful if challenged by the receiver as the representative of creditors".[4] The disclosure may be made to the directors, but only if they are independent of the promoters and not merely their nominees. In this respect the doctrine of Erlanger *v.* New Sombrero Phosphate Co., *ante,* and *In re* Jubilee Cotton Mills, Ltd.,[5] is followed.

If the company has no independent board of directors or officers all the shareholders must be informed in order to secure the validity of the agreement as to profits.[6]

The profit of promoters may and in fact frequently does consist in stocks allotted to and held by them. In such a case the corporation may sue for cancellation. Otherwise they may be compelled to surrender the profits they have unlawfully realised in cash or such other assets as they have acquired.

[1] (1909), 203 Mass. 159.
[2] Old Dominion Copper Mining Co. *v.* Lewisohn (1908), 210 U.S. 206.
[3] (1913), 227 U.S. 80.
[4] McCandless *v.* Furlaud (1935), 296 U.S. 140.
[5] (1928), A.C. 985.
[6] Densmore Oil Co. *v.* Densmore (1870), 64 Pa. St. 43.

The Federal Securities Act of 1933 is concerned only with disclosure. Form A.1.39 requires a clause in the registration statement setting forth "the name and address of each promoter to whom any amount is to be paid together with the amount thereof in each instance and the consideration of each such payment, and in so far as not tested above, the name and address of each promoter in the case of a business to be formed within two years prior to the registration statement". If the S.E.C. is not satisfied with the disclosure, registration will be refused. Otherwise the existing law is not altered or affected.

European legislations attempt a strict definition of the promoters, who are called "founders" (*Gründer*). The most thorough definition is that of Germany, initiated by the law of 1884 and extended in 1897 and 1937.

By founders is meant those shareholders who have drawn up the articles; and also, in the case of a successive promotion, those who take shares for property, i.e. make contributions other than cash, even though they take no part in determining the articles (§ 21).

The position is quite clear in both directions. Those who draw up the articles must sign them, and there cannot therefore be any doubt as to their identity. Similarly the fact that a shareholder makes his contribution wholly or partly in property must also be made clear in the respective documents.

The same liability is imposed upon those for whose account founders have taken shares (§ 39 (5)). This means that if the real promoters make use of nominees ("dummies" or "men of straw" as they are frequently called), and do not appear in person at all, they are nevertheless liable if it be proved that the nominal founders took shares for the account of persons who preferred to remain incognito.

Liability is established in favour of the company; the company only, and not the shareholders, has the right to sue.

The founders are liable for the correctness and completeness of all statements made on the formation of the company in respect of the taking of and payment for shares, the use of the amounts paid by shareholders to the company on separate advantages, expenses of promotion, or contribution in property and its acquisition. Thereby liability is imposed for failure to disclose or misstatements. The founders are further responsible for the suitability of the bank or banks authorised by them for the

acceptance of payments on the capital, and also for seeing that the amounts paid by shareholders are at the free disposal of the management.

If the company suffers damage in respect of the contributions in property or acquisitions thereof owing to wilful or grossly negligent acts of the founders or any of them, all the founders are liable to the company for compensation.

In respect of contributions not received by the company the founders are bound to make good the deficit and further damages are not excluded. If, however, the company's loss was caused by a subscriber's insolvency, the founders are liable only if they accepted his subscription in knowledge of the insolvency.

In so far as undisclosed compensation has been paid in connection with the promotion the founders have to indemnify the company. In order to avoid liability the founders must prove that they neither had nor could have had knowledge of the facts involving the liability for damages by applying the diligence of an ordinary business man.

The actual or constructive notice of the nominee is relevant for the liability of those on whose behalf he was acting as promoter (§ 39). If several persons are liable as promoters they are joint and several debtors in respect of the obligation. The company has free choice whether to sue one, some, or all of the persons who are liable under this head. He (or those) who satisfies the company may sue the others for contribution, as a rule in equal parts. The Court, however, has power under § 254 of the Civil Code to fix at its free discretion another scale of contribution in consideration of the greater or lesser degree of responsibility in the circumstances.

One who has received compensation in connection with the promotion, even though he had actual or constructive knowledge of the fact that it was not disclosed, or collaborated in the concealment thereof with knowledge of the facts, is liable to the company for damages together with the founders as a joint and several debtor. The same applies to a person who has knowledge of any detriment caused voluntarily or by gross negligence to the company in respect of contribution in or acquisition of property (§ 40 (1) and (2)).

The company cannot renounce claims against founders and other persons liable under the provisions of §§ 39 and 40 and cannot compromise in respect of them during the first five years

after registration, except by compromise made by the debtor with all his creditors in case of his insolvency to avert bankruptcy proceedings. After the lapse of this five-year period a release or compromise is possible only by a resolution in general meeting unless a minority representing at least one-fifth of the capital should object (§ 43).

The Swiss Law of Obligations regulates the liability of promoters on lines closely similar to those of the German Company law, though its provisions are much simpler and clearer.

Promoters are those who sign the original articles (§ 629); they are liable for damages if they have contributed either determinately or by negligence to the fact that the articles or the promoter's report do not correctly or completely disclose the particulars regarding contributions in property or advantages stipulated in favour of shareholders or third parties. A similar liability is imposed upon them if their wilfulness or negligence consists in the insertion of incorrect information into the register based upon a certificate or document, and lastly if they knowingly concurred in the acceptance of subscriptions from insolvent persons (§ 753). So long as the company carries on, it alone is entitled to demand payment of damages. Shareholders and creditors may bring action, but only by way of a representative suit, i.e. they may only demand payment to the company (§ 755). In case of bankruptcy it is the receiver who may sue; but if he renounces action any shareholder or creditor may demand the assignment of the claim (§ 756). A resolution in general meeting discharging promoters from their liability may be objected against the action only if the shareholder has assented to the resolution or acquired his shares subsequently in knowledge of the resolution. On the other hand action cannot be brought after six months from the day of the general meeting (§ 757).

It is expressly provided that in case of a plurality of promoters contribution may be required according to the decision of the Court based upon the degree of fault (§ 759).

The French law of 1867 provided (Art. 42) that the promoters (*fondateurs*) are liable to the shareholders and third parties in case of nullity of the formation if the avoidance is due to their fault. The law, however, did not specify who is to be regarded as a promoter, and the Courts took a rather broad view. Those who drew up and signed the articles are undoubtedly promoters, but it is held that those who authorised or caused the formation

are also deemed to be promoters incurring the same liability,[1] especially if they took shares for property, i.e. contributed *apports*. On the other hand the same liability is imposed upon shareholders who make contributions in property even if they cannot be regarded as promoters (Art. 42, par. 2).

Under some legislations there are formal criteria for the definition of a promoter. Thus the Hungarian Commercial Code declares those to be promoters who signed the memorandum (called the "draft"); § 150 makes them responsible for the truth of the statements made. This responsibility is absolute; no evidence of bad faith or negligence is required. It is criminal liability only which is made dependent on knowledge of the untruth (§ 219 (1)).

48. Defects in the Act of Creation: the Doctrine of De Facto Corporations

All general corporation laws set forth certain requirements for establishing the legal existence of corporations. If any one of these requirements is not fulfilled the question arises of the consequences of such failure and whether the corporation can exist despite such defect. This might be considered on the basis of how the requirements are to be construed. If they were regarded as mandatory, compliance with them would be a condition precedent, and its absence would make the corporation a nullity; if merely directive, failure to comply with them could not affect the validity of the corporation.

In practice the position is not so simple. The interests of third parties who have made contracts with an apparently lawful corporation imperatively require that the corporation should not be allowed to avoid their performance on the ground of defective creation. It would likewise be of the gravest detriment to public credit if shareholders could assert the non-existence of the corporation even though they had exercised their rights as shareholders. On the other hand, if the act of subscription is null, justice requires that the shareholder should not be deprived of the right to assert its nullity. The question is thus one involving contradictory interests, and may give rise to many complicated controversies.

[1] See Pic, 827.

Where registration of corporations with a public authority is required, the question is bound up with that of the effect of registration.

A company's registration with the competent authority may be looked at from two viewpoints. First, that the authority concerned merely certifies that application has been made and is apparently in compliance with the law: in other words, that the act of registration is merely declaratory. Alternatively, that the Registrar has not only the right but also the duty to examine the documents submitted with the application for incorporation and to make the necessary inquiries, and that after he has registered the company the question of the conditions precedent is settled once for all; in other words, that the decree, order or certificate is a constitutive act definitely affirming the creation of the corporation so that its validity cannot subsequently be questioned.

Actually the various legislative systems have not fully accepted either alternative. Those which look upon the act of registration as merely declaratory nevertheless do not allow its validity to be called in question unrestrictedly, whereas those which regard registration as a constitutive act permit its validity to be questioned on the ground of certain defects which they hold to be absolute obstacles to—i.e. to nullify—corporate existence.

In Great Britain until 1900 the question was disputed. Turner, L.J., said [1] that it is doubtful whether the certificate of incorporation is conclusive if the company is one that is not authorised to be registered. The Act of 1862 (sec. 18) provided that "the certificate of incorporation given by the Registrar shall be conclusive evidence that all the requisitions of this Act in respect of registration have been complied with". It is to be noted that this section mentions only the "requisitions in respect of registration" and not the existence of conditions precedent.

It was held in Peel's case [2] that although the memorandum of association had been altered after signature but before registration and without the assent of the signatories, so fundamentally that the original execution of the document was "entirely neutralised and annihilated", the existence of the company could not be called in question, and Lord Cairns said (at p. 681) that the certificate

[1] *In re* Northumberland and District Banking Co. (1858), 2 De G. & J. 357.
[2] (1867), L.R. 2 Ch. App. 674.

"is not merely a *prima facie* answer but a conclusive answer to any such objection" and that "when once the certificate of incorporation was given nothing is to be inquired into as to the regularity of the prior proceedings". Similarly in Oakes *v.* Turquand,[1] Chelmsford, L.C., said: "I think that the certificate prevents all recurrence to prior matters essential to registration, amongst which is the subscription of a memorandum of association by seven persons, and that it is conclusive that all previous requisitions have been complied with." On the other hand the dicta of the judges of the Court of Appeal, *In re* National Debentures, etc., Corporation,[2] show that in their view the certificate of incorporation might be attacked by evidence that the memorandum of association was subscribed by only six persons.

The dispute was settled by sec. 1 (1) of the Act of 1900 to the effect that "A certificate of incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requisitions of the Companies Acts in respect of registration and matters precedent and incidental thereto have been complied with and that the association is a company authorised to be registered and is duly registered under the Companies Acts." This provision has since been maintained, and is now inserted in sec. 15 (1) of the Act of 1948.

Similarly the certificate of the Registrar of Companies stating that a company is entitled to commence business is under sec. 109 (3) of the Act conclusive evidence that it is entitled so to do. It has been held,[3] that if the articles of association were in some respect contrary to law the company may be wound up, but that there is no power to repeal the charter. Even now sec. 222 of the Act contains no express provision for such cases, but the Court might wind up the company on the "just and equitable" clause. On the other hand where a company has been registered for an illegal object proceedings could be started by the Attorney-General for cancellation.[4]

Although members of the company cannot attack the incorporation, they are not debarred from contesting the validity of their subscriptions as was seen above (§ 46).

It is held in the U.S.A. that an association attains the full legal status of a *de jure* corporation only if it has been created in

[1] (1867), L.R. 2 H.L. 325, at p. 354.
[2] (1891), 2 Ch. 505.
[3] Princess of Reuss *v.* Bos (1871), L.R. 5 H.L. 176.
[4] Bowman *v.* Secular Society (1917), A.C. 406, at pp. 439–40.

full or at least substantial compliance with the mandatory provisions of the relevant statute.[1] Non-compliance with merely directive provisions does not affect its existence as a *de jure* corporation.

What is substantial compliance depends on the circumstances, especially the nature of the provision violated. It is held, however, that the State alone is entitled to question the association's existence as a *de jure* corporation, and that by direct proceedings, so that both an action by any private person and a collateral attack by the State are excluded. In such direct proceedings the burden of proof is imposed upon the corporation, but many statutes provide that the certificate of incorporation is *prima facie* evidence as against the State, while some expressly lay it down that the certificate is conclusive evidence as against any other persons.[2]

If any of the substantial provisions of the statute is violated, the corporation may still exist as a *de facto* corporation. This means that it may still exercise corporate rights and powers so long as it is not established by a judgment in the course of a direct attack that it is not even a *de facto* corporation. A collateral attack is therefore excluded. There is this difference, however, that any person interested is entitled to bring an action against the corporation and to show that it has not even a *de facto* existence, whereas if the corporation has a *de facto* existence no one but the State can bring action to deny its status as a *de jure* corporation.

In order to establish its *de facto* existence the corporation has to show that a *bona fide* attempt has been made to comply with the law and that some corporate activity has taken place. Where there was no such attempt at incorporation or where there is no general law according to which incorporation would have been possible it is generally held that the corporation has not even a *de facto* existence. The Supreme Court of the U.S.A. stated: [3] "Where it is shown that there is a charter or a law under which a corporation with the powers assumed might lawfully be incorporated and there is a colorable compliance with the requirements of the charter or law and a user of the rights claimed under the charter or law, the existence of a corporation *de facto* is established."

There are decisions holding that even if the law which would

[1] Wells Co. *v.* Gastonia Mfg. Co. (1905), 198 U.S. 177.
[2] Cf. Ballantine, ss. 20–34. [3] Tulare Irr. Dist. *v.* Shepard (1905), 185 U.S. 1.

be the basis of incorporation is unconstitutional, the corporation still may have a *de facto* existence.

In order to have made a *bona fide* attempt at compliance the steps taken must to some extent and degree have resulted in the performance of the prerequisites prescribed by the statute; but defects and irregularities do not as a rule preclude *de facto* existence. Thus it has been held that the choice of an inadequate name, the ineligibility of one or more incorporators, defects in the execution of the incorporation papers and defects in organisation do not preclude *de facto* existence. The same is held by the majority of Courts of defects as to subscriptions and payments thereof, though there are decisions holding that where no part of the capital had been subscribed or paid up there is not even a *de facto* existence. Total failure to file the documents for incorporation is generally held to deny the corporation a *de facto* existence, although even this is in some cases disputed. Defects in the papers or filing at the wrong office do not affect *de facto* existence. On the other hand if the attempt was not *bona fide*, e.g. if there was fraud in incorporating, it is generally held that *de facto* existence is to be denied, though even this is not unanimously accepted.

"User of corporate power" means the doing of some business as a corporation. Acts of the incorporators as individuals are not sufficient; some act must have been done in the quality of a corporation. The amount and extent of the user is not defined; it depends upon the circumstances.

Though in general the State alone may attack the existence of a corporation, and even then only by a direct action and not collaterally, some statutes give the State the right of collateral attack.

As long as the corporation is not ousted it has all the rights and duties of a *de jure* corporation. On the other hand it is subject to all obligations created by contract and is fully liable for torts in the same way as a *de jure* corporation. As to the right to expropriate and acquire property by compulsion there is dispute. The majority of the Courts allow this power, though some deny it.

It is to be remarked that it is always allowable to question the *de facto* existence of a company on the ground of the absence of one of its prerequisites, i.e. statutory basis, *bona fide* attempt to incorporate, or user of corporate powers.

Bona fide shareholders are held to have the same rights and to be entitled to the same protection as the shareholders of a *de jure* corporation; nor is there any difference in their liabilities. The shareholders are likewise bound by the subscriptions to stock, provided that the subscription is not preliminary to the organisation. Under legislations where subscription is preliminary to organisation a *de facto* corporation has no right to enforce subscription except in case of waiver or estoppel.

It has been held that the statutory liability of the shareholders as against creditors, e.g. in the case of a bank for public funds, holds even if the company has a merely *de facto* existence. A similar rule is accepted for criminal liability of officers and for crimes and torts committed against the corporation. Furthermore, it is to be remembered that the doctrine of estoppel is generally applied to corporations—however defective they may be—to officers, shareholders and third parties, although there is much controversy as to its application and details.[1]

By French law non-compliance with the legal requirements involved the nullity of the company under the *Code de Commerce.* This was maintained by the law of 1867. According to Art. 41 a company in respect of which the provisions of Arts. 22–5 were not complied with is void and of no effect as against the parties interested. By virtue of this provision every defect leads to nullity. This nullity must be pronounced by the Court either in the course of a direct action or by way of exception in consequence of a collateral attack. Similarly, non-compliance with the requirements as to the publication of the company's formation leads to nullity.

The consequence of the nullity—if established by the Court—is that the company is deemed not to exist (Art. 71), with the qualifications accepted by the Court.[2] Moreover, it is provided [3] that shareholders cannot avail themselves of the nullity as against third parties. The effect of a declaration of nullity is therefore tantamount to the compulsory dissolution of the company, and subsequent liability on the part of the founders and directors if the nullity is imputable to them.

Any party interested, shareholders and creditors included, may bring action, and whereas a judgment declaring nullity is

[1] Cf. Ballantine, ss. 20–34.

[2] See Cour de Cass., 8 November 1904, D. 1905, 1, 37, and Pic, s. 1013, n. 1.

[3] Art. 7 for *commandites par actions*, but held to extend to *sociétés anonymes*, and Art. 58 as amended by Order of 8 August 1935.

operative against third parties, a judgment dismissing the action does not prevent new actions by other parties, i.e. shareholders or creditors.

Since by the law of 1867 no time limit was fixed for such actions, it became obvious that the shadow of actions for nullity hung constantly over every company. It is said that there were astute persons who systematically searched through registrations and records in order to discover irregularities and to extort more or less substantial ransoms from the companies concerned by means of threats of action for nullity. This abuse became such a scandal that finally the legislature had to intervene. The law of 1893 set a term of ten years for actions of nullity. After the lapse of this time from the registration of the company no such action could be brought. Moreover, if the irregularity attacked had been amended by the time when the writ was presented to the Court, or if a general meeting whose agenda included the amendment of the irregularity had been convened, the action was barred.

The Order of 8 August 1935 went further. Even if the amendment was carried after presentation of the writ, the action is to be dismissed if the resolution of the general meeting was passed during the proceedings before the Court of first instance has given judgment. In that event, however, the costs fall on the company. Moreover, the Court was empowered even without application to grant a respite to the company during which the irregularity could be amended.

These legislative measures to a large extent countered the dangers of the doctrine of nullity, while maintaining the principle that the registration of a company is merely declaratory.

The German doctrine held that registration was always a constitutive act which could be avoided only for substantial defects, and the legislative trend ran constantly towards restricting the possibility of actions for nullity. This culminated in the regulation contained in the law of 1937, by which (§ 216) any shareholder, and also any member of the management or board, may sue for a judicial declaration of nullity. Such action may be based only on a violation of the law in respect of any of the following points: (1) name or seat of the company; (2) object of the enterprise; (3) amount of the capital; (4) the par value of the shares and, should more than one class of shares exist, the fixing of the different classes; (5) the form of publication. If

the articles do not contain provisions in respect of any of these matters, or such provisions are contrary to the law, action would lie.

There is one important qualification. The nullity may be rectified by alteration or supplementation of the articles, except when the defect relates to the amount of the capital or the par value of the shares, or the provisions as to different classes of shares.

It is clear that companies whose articles were defective as regards the capital or the shares would hardly be registered by the Court. As to defects in respect of the other provisions, it is laid down that a plaintiff, before bringing action, must communicate with the company and request adequate amendment within three months, otherwise the action is to be dismissed. It is most improbable that any company would refuse such a request. No action may be brought for any other defect in the formation, however substantial (§ 216 (1)), and no action for nullity is admitted after five years from registration (§ 216 (3)). Moreover the company may demand security from the plaintiff if it can produce *prima facie* evidence that the action may cause damage to the company (§§ 216 (4) and 199 (4)). If shares owned by another person are used for the purpose of bringing an action for nullity without the owner's consent there is a fine not exceeding one hundred thousand marks, and the same fine may be imposed upon both the owner and the user of the share if the assent was given for a consideration (§ 300 (1) and (2) respectively). On the other hand the Court has power to order the company to be struck off the register for any defect falling within the ambit of § 216 and § 16 (3) as before quoted.

If a company is declared void it is to be wound up according to the provisions governing company liquidation. The validity of contracts made by it before the judgment came into force is not affected, and shareholders are bound to pay the outstanding remainders in so far as that may be necessary to satisfy creditors (§ 218).

The essence of this complex regulation is that defects in the act of formation may result in the compulsory winding-up of the company, but only at the request of a shareholder or a member of the board of management or supervision, and in no case at that of a creditor.

The Swiss law provides that the company acquires juridical personality by virtue of its registration even if the conditions precedent do not exist. Any shareholder may bring an action

for winding-up within three months after the publication of the company's registration in the *Gazette* if the law or the articles are violated in connection with the formation, provided the defect impairs or substantially endangers the interests of the shareholders or creditors. After the writ of action is presented the judge has power to make provisional orders at the request of one of the parties, *inter alia*, for amendment of the articles.

49. Contracts before Incorporation

It is everywhere recognised that a company attains the status of a separate legal entity by incorporation, and that only from that time forward is it capable of making contracts, acquiring rights, and incurring obligations. Until then no one can act in its name or contract on its behalf. On the other hand it is and must be the aim of the incorporators and promoters to provide a plan for the company's future business, and to take steps to secure the ground of corporate life by making agreements or arrangements on a contractual basis.

The attitude of the various legislative systems to such pre-incorporation contracts and agreements is not unanimous. The British Act of 1948 (sec. 13 (2)) says, that "from the date of incorporation mentioned in the certificate of incorporation the subscribers of the memorandum together with such other persons as may from time to time become members of the company shall be a body corporate . . . capable forthwith of exercising all the functions of an incorporated company and having perpetual succession. . . ."

It was formerly held that preliminary contracts on behalf of the company might be ratified or adopted by it after it had come into existence. Since Kelner *v.* Baxter,[1] however, it has been held that a contract made before incorporation by a person purporting to act on behalf of a company cannot be ratified by the company, and that for such an agreement to be operative as against the company a new contract must be made after the company has come into existence.[2]

[1] (1866), L.R. 2 C.P. 174.

[2] See *re* Empress Engineering Company (1880), 16 Ch. D. 125, in which case James, L. J. said that the company cannot ratify a nullity; further Howard *v.* Patent Ivory Manufacturing Co. (1888), 38 Ch. D. 156; North Sydney Investment, etc., Co. *v.* Higgins (1899), A.C. 263; Bagot Pneumatic Tyre Co. *v.* Clipper Pneumatic Tyre Co. (1902), 1 Ch. 146; Natal Land, etc., Co. *v.* Pauline Colliery, etc., Syndicate (1904), A.C. 120.

What is necessary for the making of a new contract depends on the circumstances. The insertion in the articles of a clause to the effect that a contract is adopted by the company is not sufficient. Such a clause may be good in order to make the contract *intra vires* provided it is actually concluded after incorporation. Further, it has repeatedly been held that even if a company takes the benefit of a pre-incorporation contract it is not bound by it.[1] That the company regarded the contract as valid and acted upon it is held to be immaterial.

Promoters, in order to overcome this difficulty, frequently make contracts by means of a trustee acting in the interest of the company to be created. Even in such a case a contract with the trustee is necessary.

The effect of the prohibition against commencing business before the company becomes entitled to do so under sec. 109 of the Act of 1948 is quite different. Apart from the liability to fine which the directors and other persons responsible incur for contravention under sec. 109 (6), it is provided by subsec. (4) that any contract made during this period "shall be provisional only and shall not be binding on the company until that date and by that date it shall become binding". This is not a rule of construction to the effect that such a contract is deemed to have been made as a provisional contract; it means that no contract made after registration but before the company becomes entitled to commence business is binding on the company until it acquires the right to commence business. It has therefore been held that if a company is wound up without having become entitled to commence business it cannot be sued.[2] On the other hand persons who make contracts on behalf of a company before its incorporation are liable as against third parties. That they purport to act for the company is immaterial.[3] Even if the company makes a new contract with the other party the liability of such persons remains unless there is a release; they may exclude liability by a clause inserted in the contract.

In the U.S.A. certain statutes expressly declare that corporate existence begins with the filing of the certificate of incorporation.[4] Even where the statute does not contain any such express provision

[1] *Re* Northumberland Avenue Hotel Co. (1886), 33 Ch. D. 16; Clinton's claim *in re* National Motor Mail Coach Co. (1908), 2 Ch. 515, C.A.
[2] *Re* Otto Electrical Manufacturing Co. (1906), 2 Ch. 390.
[3] See especially Kelner *v.* Baxter (1866), L.R. 2 C.P. 174.
[4] See e.g. New Jersey Rev. Stat., s. 14 (2–4) as amended by L. 1939, c. 249.

it is recognised that before incorporation no one may act as agent for a corporation which is to come into existence in the future. Consequently pre-incorporation contracts cannot either bind or be enforced by the corporation.[1] In many States, however, it is held that a corporation may adopt such contracts after it has been incorporated, and in that case they are binding. It is frequently stressed in the decisions that adoption is not identical with ratification, and that a ratification would not be possible, since it would presuppose a principal at the time when the contract was made. But this distinction is rather theoretical. It is true that the contract becomes binding by virtue of its adoption and does not relate back to the date on which it was made by the promoter or other person purporting to act on behalf of the corporation. On the other hand a contract once adopted by the corporation has the same effect as it would have had if it had been made originally by the corporation had it been then in existence, or had been made by an unauthorised agent of a corporation already in existence and later ratified by the latter.[2]

Where adoption of a contract made before incorporation is admitted, it is generally held that such adoption may be implied and that explicit adoption is unnecessary. What constitutes implied adoption is a question of fact. Adoption may be implied if the corporation accepts or takes the benefits of the contract. The question whether and how far this has occurred may give rise to dispute, especially in the case of connected contracts. Thus, in Weatherford, etc., Ry. Co. *v.* Granger,[3] it was held that although the corporation accepted the bonus subscription procured by Granger under an agreement made with a promoter, and was therefore bound as against the subscribers according to the terms of the subscriptions, it was nevertheless not bound to pay the fees promised by the promoter to Granger.

Another question is that of the liability of the promoters for such contracts as against third parties. As a rule promoters or other persons acting in the name or on behalf of a corporation not yet in existence are liable for the performance of the contract, and the fact that the corporation has become liable does not affect their position. It is otherwise if it was stipulated beforehand that the promoters shall be released if the corporation adopts the contract; this of course is the case if in connection with the adoption there is a renovation with the effect that the corporation steps

[1] See Ballantine, s. 40. [2] Cf. Ballantine, s. 41. [3] (1894), 86 Tex. 350.

into the place of the promoters. Apart from these cases promoters remain liable, and the parties to the contract may sue either the corporation or the promoters or both.

The French law contains no provisions in respect of pre-incorporation contracts, and the Courts hold that since the company has no existence before incorporation, contracts made prior to registration are void, and that those who make the contracts are personally liable.[1] This doctrine is extended even to subscriptions, so that their validity is disputed until the formalities of incorporation are complied with. In the literature there is an inclination to attribute over this transitory period a so-called internal existence of legal relationship between the founders and the subscribers, though it is admitted that in the absence of legal regulation the possibility of such internal existence is doubtful and its legislative regulation is advocated. Even those who follow the doctrine of internal existence hold that without assignment and adoption the company has no rights under and is not bound by pre-incorporation contracts.[2]

In the law of Germany and of the other countries which follow its example the role of pre-incorporation contracts is peculiar, especially if it is intended either to issue shares for property or to acquire property by contract. At the same time the complicated machinery of so-called successive formation necessitates a certain number of contractual acts which are required for a company's creation. The regulation provided by the law of 1937 is consequently exhaustive, although in actual practice the promoters nearly always avail themselves of the simultaneous form of creation.

As we have already seen, every agreement dealing with contributions in or acquisitions of property, any advantage or privilege to be granted to shareholders, any compensation connected with the formation, and lastly the amount of expenses of formation and promotion, is to be stated in the articles, otherwise it is inoperative as against the company (§§ 19, 20). These agreements are necessarily a part of the articles. If and in so far as they are included in the articles, they become operative automatically on the company's registration, no further act being required. In so far as they are not included they are invalid, and this defect cannot be rectified after the registration.

It is usual to draw up and execute separate documents, but

[1] Sirey 90.1.25, and 95.2.105. [2] Pic, 840–3.

such documents are irrelevant from the standpoint of legal validity; if they differ materially from the relevant clauses of the articles they are invalid. If, however, they were duly included in the articles, the company is entitled to all rights and benefits of the agreement and incurs all duties and obligations so imposed. Accordingly it is expressly provided (§ 34 (3)) that the company cannot take over by separate agreement any obligation as to contributions in and acquisitions of property. Any contract or agreement in contravention or evasion of this provision would be void. No such express provisions in respect of separate advantages and compensations are found in the law; but it is held that the rule extends to these matters also.[1] As to other contracts (§ 34 (1)), it is provided that any person who acts in the name of the company before it is registered is liable for the contract, and if more than one person does so they are liable jointly and severally. The company may, however, take over the contract by agreement with those who acted on its behalf, with effect that they are released. If such an agreement is made within three months after registration, the assent of the other contracting party is not required (§ 34 (2)). This provision applies only to contracts made in the name of the company. If the contract was made otherwise, e.g. in the name of the *Gründer* or one of them, such a novation is possible only with the consent of the other party. The same applies if the company did not avail itself of the three months' term.

Shares cannot be transferred before incorporation (§ 34 (4)). This provision applies to any transfer of the rights arising from subscriptions. It was previously provided that such transfer is inoperative as against the company, and its validity as between transferee and transferor was disputed.[2] The dispute is now settled in the sense that such transfer is barred. Similarly, the issue of share certificates, even provisional, is prohibited, and certificates issued in contravention are declared void, and do not become valid on the company's registration. Consequently those who have issued the share certificates are jointly and severally liable for damage caused by the issue (§ 34 (47)).

In connection with these provisions it is not without interest to note how the German doctrine evolved in respect of the chrysalis phase of corporate life. It is asserted that although the company does not exist as such before registration ("*Vor der*

[1] Gadow, p. 109, n. 17. [2] So R.G.Z. 85, 33, but R.G.Z. 136, 399, *contra*.

Eintragung besteht die Aktiengesellschaft als solche nicht") its effective life begins earlier. This pre-corporate life is regarded as beginning with the drawing up of the articles and the placing of the shares. The law (§ 22 (1)) provides expressly that if the *Gründer* have taken up all the shares the company is formed ("*die Gesellschaft ist errichtet*").

As to the character of the association at this stage there are several views. One is that it is a company which, although without corporate entity, is otherwise identical with the company which comes into existence later on registration. Another is that it is an unregistered association under private law. The third view is that it is a *societas* governed by the provisions of the Civil Code. The aim of these reasonings is to assert that even before registration there is a legal relationship between the founders, by virtue of which they are bound to co-operate in taking all steps necessary for incorporation, so that none of them can withdraw without the consent of the others unless there is some lawful reason for the dissolution of the *societas*.[1]

The provisions of the Swiss law (644, 645) are substantially identical with those of the German.

[1] See Wieland, s. 95; Gadow, pp. 107–8.